

The Indonesian Quarterly

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- ☐ Accelerating Economic Regulatory Reform :
Indonesia and International Experience
- ☐ Indonesia and Singapore :
The Battle for Power, Money and Space

REVIEW OF POLITICAL DEVELOPMENT

- ☐ SBY - JK Government :
Effort to Build Image and Maintain Law and Order

REVIEW OF ECONOMIC DEVELOPMENT

- ☐ Indonesia's Economy : Improving, but at a Mere Snail Pace

REVIEW OF REGIONAL AND GLOBAL DEVELOPMENT

- ☐ Indonesia Confronts Strategic Regional Issues

ARTICLES

- ☐ Macroeconomic Policy Reform Strategy for Regional Cooperation
- ☐ Major Powers Relations and East Asian Regionalism
- ☐ Proliferation Security Initiative (PSI) : Indonesian Perspective



CENTRE FOR STRATEGIC
AND
INTERNATIONAL
STUDIES

The Logo



The Indonesian Quarterly is a journal of policy oriented studies published by the Centre for Strategic and International Studies (CSIS), Jalan Tanah Abang III/23-27, Jakarta 10160. It is a medium for research findings, evaluations and views of scholars, statesmen and thinkers on the Indonesian situation and its problems. It is also a medium for Indonesian views on regional and global problems. The opinions expressed in *The Indonesian Quarterly* are those of their authors and do not necessarily reflect the opinion of the CSIS.

To better represent the underlying ideas that gave birth to the CSIS in 1971 the Centre uses as of 1989 the logo that figures on the front cover of this journal. The original, in bronze, designed by G. Sidharta, it consists of a disc with an engraving that depicts the globe which serves as a background to a naked man with an open book laid on a cloth over his lap, his left hand pointing into the book, his right hand raised upwards. Altogether it symbolises the Centre's nature as an institution where people think, learn and communicate their knowledge to whoever are interested, to share it with them, mankind the world over being their concern and the globe their horizon. The nakedness symbolises the open-mindedness, the absence of prejudice, in the attitude of the scholars who work with the Centre, just as it is with scholars everywhere. The inscription reads "*Nalar Ajar Terusan Budi*", which in the Javanese language essentially means that to think and to share knowledge are only the natural consequence of an enlightened mind. It is a *surya sengkala*, that is *chandra sengkala*, a Javanese traditional way to symbolise a commemorable year in the lunar calendar, adapted to the solar calendar system. It consists in using words that express the perceived meaning of the commemorated year while marking the year at the same time, each word having a numerical value. Thus, the inscription, in reverse order, represents the year the CSIS was established: 1971.

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ABSTRACTS

MACROECONOMIC POLICY REFORM STRATEGY FOR REGIONAL COOPERATION

By Hadi Soesastro

Regional economic cooperation in East Asia has been driven by economic reforms that have been independently undertaken by regional economies. Regional cooperation has also helped to strengthen the commitment to open economic policies. This article discusses the importance of microeconomic reform for East Asian economies. The author is of the opinion that APEC provides a useful forum for the East Asian economies to support their efforts to effectively respond to the challenges of second generation economic reform. But he argued that for APEC's own sake, it should make microeconomic reform a priority.

MAJOR POWERS RELATIONS AND EAST ASIAN REGIONALISM

By Jusuf Wanandi

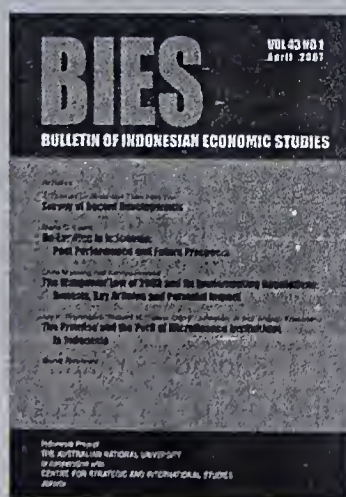
There are two views of East Asia: the pessimistic and the optimistic. The pessimists believe that East Asia has to depend primarily on the balance of power because regional institutions and regional order are almost non-existent in East Asia. They also point to the fact that East Asian regional institutions remain under-developed and are based on "shallow" cooperation. Instabilities, tensions and conflicts are therefore likely

to occur. The second view is cautiously optimistic about the future of East Asia. It is partly based on some realism but this is tempered by the ideas of regionalism and regional cooperation. The author said that since East Asia is going to become the next important region, the responsibilities of the East Asian regional institutions in delivering and supporting global common goods should also be considered as an important part of the rise of the region.

PROLIFERATION SECURITY INITIATIVE (PSI): INDONESIAN PERSPECTIVE

By *Hasjim Djalal*

The US Proliferation Security Initiative (PSI), launched in 2003, was motivated by the global fight against terrorism and the fear that the WMD could fall into the hands of terrorists or the so-called 'rogue states'. So far, the US has gathered supports from some 70 or so of its allies and friends who have agreed to the PSI Statement of Interdiction Principles. The Initiative, if implemented, may fundamentally affect the development of the Law of the Sea and maritime issues. The writer is of the opinion that in view of all these Law of the Sea stipulations, which Indonesia and the majority of countries in the world have ratified, it would seem difficult for Indonesia to comply with the PSI principles, particularly if it would be implemented in the waters under its territorial sovereignty.



The *Bulletin of Indonesian Economic Studies* (BIES) is a peer-reviewed journal published by the Indonesia Project, The Australian National University.

The journal fills a significant void by providing a well respected outlet for quality research on the Indonesian economy and related fields such as law, the environment, demography, education and health. In doing so, it has played an important role since 1965 in helping the world, and Indonesians themselves, to understand Indonesia. In addition to papers reporting economic analysis and research, each issue leads with a 'Survey of Recent Developments', which aims to be accessible to non-economists, and helps to account for the journal's diverse readership within academia, government, business and the broader public.

The BIES is published three times a year, in April, August and December and is available in Indonesia from CENTRE FOR STRATEGIC AND INTERNATIONAL STUDIES, Jalan Tanah Abang III/23-27, Jakarta 10160, at Rp 120.000,00 per year, Rp 45.000,00 per issue.

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CURRENT EVENTS

SUMMARY OF WORKSHOP

Accelerating Economic Regulatory Reform: Indonesia and International Experience

Introduction

THE PURPOSE of the workshop was to discuss strategies to accelerate economic regulatory reform by sharing Indonesian and international experience. The goal was to improve the regulatory framework to support a more conducive business environment, leading to a more competitive economy with greater employment and investment levels and lower poverty. The two day workshop generated tremendous interest and was well attended by business people, academics, senior government officials, and representatives of civil society. The main conclusion was that, despite steady progress over the past two years, regulatory reform has been too slow. Consequently the business environment has not improved enough to support the high investment levels that Indonesia needs to boost economic growth, cut poverty, and reduce unemployment. More rapid progress requires a more comprehensive approach that shifts the burden of proof from reformers to regulators. The international practitioners highlighted that in the next 18 month, if more effective approaches to economic regulatory reform are adopted, the web of regulations constraining business in Indonesia could be greatly simplified. The government of Indonesia therefore has an historic opportunity within its current term to dramatically improve Indonesia's investment climate. A strong push from the top is needed to implement these reforms. The Workshop, held in Jakarta, April 10-11, 2007, was jointly organized by the Government of Indonesia, the World Bank Group, the Centre for Strategic and International Studies, and the Asia Foundation; with financial support from the Government of Japan, the Government of Netherlands, and United States Agency for International Development.

Main Findings of the Workshop:

- 1- There was general agreement that the pace of reform can and should be accelerated so that Indonesia is not left behind by its regional competitors.

"If we are to maintain our competitive position and attract sufficient investment to reach our growth, poverty and employment goals, we need to improve the implementation of regulatory reform efforts at all levels of government" Dr. Mari Pangestu, Trade Minister.

- 2- International experience has shown that an ad hoc or piecemeal approach to regulatory reform generally does not result in sustainable improvements to the regulatory framework. Bureaucratic resistance undermines efforts to clean up the existing stock of regulations, and bad regulations that are reformed or eliminated tend to be replaced over time by new regulations that are equally bad. A more comprehensive reform strategy is needed for effective and sustainable results. This requires commitment at a high level in government.

- 3- Neither a piecemeal nor a big bang approach is likely to work. Indonesia could aim at something in the middle, a "two-tier approach":

- a. deal with immediate policy issues, and
- b. have a long-term reform strategy into which short-term reform efforts are framed and institutionalized.

- 4- While Indonesia faces legal constraints in improving regulations, many countries have found ways to accom-

modate economic regulatory reform in the context of existing laws.

*"Participants claim that article 33 of the constitution limits any possible reform, but that is a small obstacle; in Vietnam we had the entire constitution against us..."
Vietnamese practitioner at Workshop*

- 5- Broader participation from civil society could help accelerate reform.
- 6- Indonesia faces conditions that triggered systematic reform in other countries, like bilateral and multilateral trade negotiations and enhanced competition with regional economies.

The objective of regulatory reform is not deregulation; rather it is to improve the quality of regulations. Typically, one-half of regulations fail to achieve the objective of regulators, and many accomplish the opposite. Improving the capacity to create smart new regulations, particularly in areas such as consumer safety, health, and environment, is essential.

The benefit of economic regulatory reform has been estimated to range from 1% of GDP in the US to 5 and 5½ % in Japan, Germany and France.

- 7- Regulatory reform is not a panacea and will not solve all the country's problems. The public's expectations therefore need to be managed.

Main Recommendations of the Workshop:

- 1- An inventory of existing regulations should be established to improve legal

certainty and to create awareness of the magnitude of the regulatory burden. As the saying goes, "what get measured, get changed". Domestic research institutions could support the Government in this effort.

- 2- A public-private working group could be established to promote regulatory reform. The group could examine reform models suitable to Indonesia and help build consensus through discussion. One of the topics for discussion could be whether a piecemeal approach should be continued or a comprehensive reform strategy introduced.
- 3- It is advisable to employ communication/advocacy tools to raise awareness and maintain momentum for reform. Regulatory reform can become very popular among voters, both as a means to cut red tape and to reduce official corruption. It was one of the main campaign messages during elections in Bosnia, Croatia and Korea and was supported by all the main parties.
- 4- It is advisable to establish a central unit within government outside the line ministries to supervise the quality of regulations.
- 5- Other ministries could benefit from the internal reform program that the Indonesian Ministry of Finance has embarked on.
- 6- Consider introducing reform tools proven to work in other countries (see below).

Tools available for economic regulatory reform:

Experience in other countries shows that for lasting change, reforms must address the existing stock of regulations, the flow of new regulations, and the implementation of regulations. Countries have made use of the following tools to achieve these goals:

- Tools to improve the stock of existing regulations:

Regulatory Guillotine: The regulatory guillotine is a tool to reduce the stock of existing regulations. Line ministries and government agencies are required to submit a complete list of all regulations that they want to keep along with a justification for each regulation based on standard criteria. Only regulations justified as necessary remain; everything else is eliminated. An advantage of this approach is that the burden of proof is reversed. Rather than reformers having to justify every change, line ministries and government agencies must prove the need for their regulations. A reform-minded government therefore does not have to fight a political battle for each regulation.

Three criteria are used to determine if a regulation should be kept: (1) is it needed?, (2) is it legal?, and (3) is it business friendly? A central review unit is established to ensure that the review is neutral. The review is conducted by the unit – combining officials, the business community, independent experts and civil

society – is established to ensure that the review is neutral. The package of filtered regulations is presented to the government, which gives a yes or no vote. The list of regulations is then published electronically for transparency and is updated continuously. No new regulation is legally valid until entered into the electronic registry. The scope of the guillotine can be broad or selective in terms of the ministries and legal instruments covered. Eight countries have successfully adopted the approach. In Korea, about 50 percent of regulations were eliminated in 11 months, and the reform had a significant positive impact on the economy (see Table 1).

Table 1. Projected Economic Impacts of the Korea Guillotine

Created jobs:	1,066,200
Reduced public burden:	\$18.7 billion (4.4% of GDP in 1997)
Increased foreign direct investment:	\$36.5 billion extra over 5 years

Source: Byung Ki Ha (1999), cited in Workshop presentation by Scott Jacobs (2007) of Jacobs & Associates.

Reduction of administrative burdens: To simplify the burden of complying with existing regulations, departments and ministries are required to estimate the cost to the private sector of complying with their regulations in terms of man hours. Each ministry is then required to cut the cost by a certain percentage (for example, 25% in one year in the case of Netherlands) or risk being penalized by the Ministry of Finance for non-compliance.

- Tools to ensure that the flow of new regulation is of good quality:

Regulatory Impact Assessment (RIA) consists of reviewing proposed new regulations to ensure that they are of good quality. It helps government officials identify whether a regulation is really needed, examine its potential impact, consider policy alternatives, and consult the relevant stakeholders early in the process. The OECD has found that the use of RIA improves cost-effectiveness of regulations and reduces the number of low-quality and unnecessary regulations. It also improves transparency of decisions, enhances consultation, and improves inter-ministerial communications. In Indonesia, RIA is being implemented in more than 20 districts and at the Ministry of Trade.

International experience suggests that a key requirement for sustainable regulatory reform is the establishment of a central unit reporting to the President and empowered to review existing and new regulations created by line ministries and government agencies.

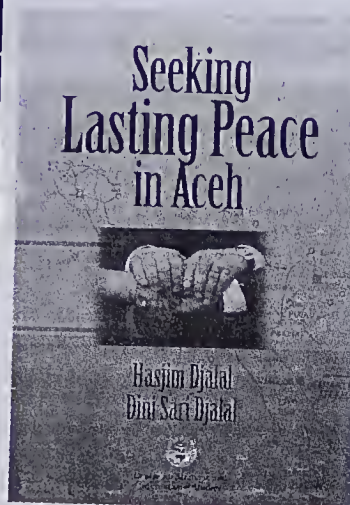
- Tools to secure the effective implementation of regulations:

However, establishing a high quality regulatory framework is, in itself, not sufficient for a good investment climate. Effective implementation of regulations is also needed. The use of integrated investment service or “One-Stop Shops” (OSS) has proven effective in this regard. OSS helps reduce cumbersome business regulatory services by integrating services within one office, thus cutting time and

costs. Factors for the successful establishment of an OSS include: previous simplification of existing regulations, political commitment, a narrowly-focused and clearly defined role, and clear delegation of authority from technical departments to the OSS. An OSS with imprecise authority runs the danger of turning into

yet another stop for businesses, while a centralized OSS that replaces too many of the functions of line ministries could result in a huge and unwieldy bureaucracy, and might also be politically unfeasible. The most effective OSS are those established at the local-level with authority to issue local business licenses.

SEEKING LASTING PEACE IN ACEH



Authors: *Hasjim Djalal* and *Dini Sari Djalal*

Published by *Centre for Strategic and International Studies (CSIS)*, Jakarta.

After nearly 30 years of armed conflict, peace agreement was finally achieved between The government of Indonesia and the Free Aceh Movement (GAM) in 2005. This was then followed by the enactment of a new law on the Governing of Aceh to be used as the basis on which Aceh can exercise authority over its own affairs.

In this book, the authors conclude that it requires a strong consolidation to have a long lasting peace in Aceh. Consisting of 30 essays in total, the book is divided into 6 parts. The first part, consisting of 8 essays, outlines the history of the conflict. Part Two presents 7 articles focusing on the long journey toward peace.

Part Three comprises 6 essays discussing the tsunami and its impact on the Aceh peace process. The rest contains essays focusing on the peace process and its implementation.

The book is useful for those who need to know more about peace in Aceh and its future challenges.

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Indonesia and Singapore: The Battle for Power, Money and Space

Bantarto Bandoro

INDONESIA – Singapore relation was again on the radars of both countries when they signed the extradition treaty and defence cooperation agreement. Unlike the public in Singapore who were mostly silence about the issue, the reactions of the public in Jakarta were rather uncooperative, if not hostile, particularly toward the defence cooperation agreement. The relationship between the two countries strained again¹. These document however cemented the two countries bilateral bonds as the leaders of both countries continued to show strong commitment to create a conflict-free relations. The signing of these two document signifies the importance of being a close neighbors as well as building a long-lasting mutual trust.

Our politicians here seemed to have been uneasy over the signing of the defense cooperation agreement, while relatively receptive enough toward the extradition

treaty. The government officials on the other hand stressed the importance of the treaty, though it recognized the need to further clarify certain issues with Singapore.

What is it that brought the two countries into a pulling and hauling type of relationship? It may have something to do with imbalances both countries have over each other on the aspect of power, money and space. Indonesian defense minister Juwono Sudarsono once reiterated that the issue being negotiated between Indonesia and Singapore is money and space as both have advantages and disadvantages over one of this aspects.

It is a political reality that Singapore has often been scapegoated by its much bigger but much less wealthy neighbor, Indonesia, for its domestic chaos. The giant neighbor also likes to bully the city state. But outward-looking Singapore continues to prosper, leaving the intimidating friend far behind.²

¹ The strained caused by emotional and historical baggage. For highlights on this see Jusuf Wanandi, "Indonesia-Singapore relations: Strained again," *The Jakarta Post*, July 9, 2007.

² "Suspecting Singapore," *The Jakarta Post*, May 24, 2007.

This is not the intention of this article to discuss the substantial elements of the two documents mentioned above, but to shed lights on how and why the relationship between Indonesia and Singapore have reached to such level in which both have so far been consistent in their position *vis a vis* each other over certain bilateral issues.

Singapore's decision to finally sign extradition treaty and defense cooperation agreement is a clear reflection of its intention to continue to be part of regional activities. The signing also serve to reflect Singapore's foreign policy and independence. Singapore success and independence are the sum of its strategic relevance for the key regional player like Indonesia and other global powers as well as for the international economic system as a whole.

For Singapore, as a hub for international business activities, the business of diplomacy is about making friends with whom it shares common interests. It is perhaps within this context, if not something imperative, that the execution of Singapore's foreign policy needs to involve other states in its well being.

It is true that many see Singapore as a small country. In his autobiography, *From Third World to First*, Minister Mentor Lee Kuan Yew recalls how Indonesia's third president, B.J. Habibie, described the city state as a little red dot compared to his country. One would admit that inspite of rapid pace of globalization, the world is still largely organised around the principle

of power, and therefore dominated by big powers.

The post-colonial literatures on small states quated smallness with weakness and vulnerability, and viewed their survival as extraordinary. Singapore had often been on a short list that included others like Denmark. Small states - that survive - are assumed to have been much better organised and flexible enough to meet challenges quickly. What Singapore did in its relations particularly with a much bigger Southeast Asian countries was exactly meant to exhibit its flexibilities in facing external challenges.

But one must acknowledge that not all small states were created equal. Singapore happened to exist in tougher neighbourhoods. However, it is in such kind of neighbourhoods that it helps to have a strategic resource. Foreign countries continued to eye on Singapore as the the best site for investment as well as reliable supplier for certain strategic resources, such as technology.

As a small states, Singapore face unique and complex combinations of geopolitical and economic circumstances. It needs to be exceptionally successful, to hopefully play out a relevant and useful role within the regional system. Singapore has sucessfully shown its capability in facing severe challenges resulted from complex combinations of geopolitical and ecomonic circumstances.

In a regional context, Singapore, though small, has always sought friendly relationships with its neighbours, based on the principle of mutual respect and

benefit. The country has signed many political as well as economic agreements with its immediate neighbors upon which cooperative interaction is to be based. Within the grouping of ASEAN, Singapore functions almost as a think tank for fresh regional initiatives. The ASEAN Regional Forum was initially driven by Singapore.

As a neighbour to a much bigger but less wealthy states, it is inevitable that disputes should arise from time to time. The source of dispute is assumed to have been related to elements of power, money and space. The current and previous war of words between Indonesia and Singapore is an evidence of how money; power and space has affected the way the two neighboring countries should go about their relationship.

Singapore intensive and continued contacts with its neighbors is a function of its foreign policy which is predicated upon countering its vulnerability. For state like Singapore, vulnerability can only be addressed by expanding and maintaining contacts not only with extra regional powers, but also with its immediate, though less wealthy neighbors. In the eye of foreign policy analyst, Singapore exhibits activism in search for political, economic and strategic space.³

It is to say that creating political and strategic space and building a secure web of connection with other states, neighbors,

regional entity or major powers, has been and will continued to be Singapore's core strategy to overcome vulnerability. Perhaps, it is against such background that Singapore decided to launch defence co-operation agreement with Indonesia in its attempt to seek for a much wider and secure strategic space for its military training.

Indonesia's influential role in Southeast Asia is globally and regionally recognized. It is assumed that it will continued to play central role in the maintainance of peace and stability in the region. As a "big brother", Indonesia feels the "pleasure" to enact major regional policies that many in the region think is indispensable in helping create a stable region. However, it is in a such framework of self perception that Indonesia has always felt uneasy about the way other countries in the region see Indonesia.⁴

Indonesia's status as "big brother" however does not make the country totally immune from any domestic turbulences nor from foreign criticism over its way of handling national matters. It is a reality that this nation is becoming more and more xenophobic, if not paranoid of foreigners. Maybe this is because Indonesia cannot cope with its growing inferiority complex in the face of more advanced nations.

³ Bilveer Singh, *The Vulnerability of Small States Revisited: A Study of Singapore's Post Cold War Foreign Policy*, (Yogyakarta: Gajah Mada University, 1999).

⁴ See for example Jusuf Wanadi, "RI, S'pore: Understanding and being understood," *The Jakarta Post*, March 6, 2002.

The greatness of Indonesia, at least in the eyes of its immediated neighbors, is not only its vast geographical areas, population and natural resources, but also shaped by the legacy of the Indonesia history that it has demonstrated its determination to become great country in the region. Sadly, Indonesia's greatness does not develop in line with its degree of maturity as a big nation.

Indonesia often exhibits childish gesture toward its neighbors particularly when its political desires were met with resistance. The banned by Indonesia of sand export to Singapore, due to the allegation that Singapore intentionally delayed in realizing extradition treaty, is a case that best described Indonesia's childish attitude. The ban risked another set back in the oft-strained relation with Singapore. How can one be so confident that the extradition treaty will be a magic bullet to eradicate Indonesia's widespread corruption problem. Indonesia is battling to get the illegal money parked in Singapore back home. But many believed that the money is no longer there.

There is an observation that the feeling of being great on the part of Indonesia has dictated the way Indonesia treats its neighbors. Indonesia's neighbors might also think that they will respect Indonesia only when Indonesia can prove that it is able to play a leading role in improving security and prosperity in the region while treating individual neighboring countries equally.

Defense cooperation agreement, one that Indonesia and Singapore has, at least for now, failed to reach a satisfactory

settlement over the implementation aspects, is another case that reflects how Indonesia, being the greater of the two, has succeeded in making Singapore feels that it needs the treaty more than Indonesia. This is where the battle over space come into the picture. It is not yet clear who will actually "surrender" in such pulling and hauling process as both seemed to have been firmed in their repsective positions over certain aspects of the treaty.

Another sign of being "proud" as great country is a threat from Indonesian legislators to veto the defense agreement, saying that Indonesia's sovereignty is in great danger while Singapore will get much. An objective assessment would be that a give and take relationship is unavoidable even between big and small country like Indonesia and Singapore. It is not to ignore the fact that through the agreement Indonesia will also have access to Singapore's sophisticated military technology and facilities. There is always room for even a small state like Singapore to play positive role to assist Indonesia in the development of its military technology.

It is absolutely true that it is the duty of the government of Indonesia to ensure that any international treaty provides maximum benefit to the people. Singapore of course also has the right to expect the same. The battle, particularly on the part of Indonsia, to get maximum benefit from the treaty should not however be based upon the belief that "big brother" can do no wrong, but rather upon the belief that Indonesia and Singapore both deserve to have defense cooperation agreement.

REVIEW OF POLITICAL DEVELOPMENT

SBY-JK Government: Effort to Build Image and Maintain Law and Order

Vidhyandika D Perkasa & Ignasius Ismanto

INTRODUCTION

THE RESULT of study conducted by Indonesia Survey Institute (*Lembaga Survei Indonesia/LSI*) in March 2007 had shown that at the national level only less than 50% of the total registered voters favored the performance of President Susilo Bambang Yudhoyono (SBY) and Vice President Jusuf Kalla (JK). According to LSI, for the last two and a half year of their term of office this was the lowest rate of the public satisfaction toward SBY-JK performance. The rate decreased by 30% and by 17% as compared to the rates in November 2004 and December 2006 respectively.

In spite of such decline, the popularity of SBY-JK still exceeds that of other presidential candidates for the 2009 general election. If the presidential election were held in March 2007, president SBY would have gained 39.2% of the total votes, whereas Megawati, Wiranto and Hidayat Nur Wahid would gain 25.5%, 5.7%, and 3.2% respectively.¹

President SBY has enjoyed such popularity while attempting to maintain it for the remaining two years of his terms of office. To this end, he has focused on his people-favoring policies and maintained the current social law and order. Those policies were reflected in president's efforts to eliminate corruption practices—such as, Bulog case, the case of Tommy Suharto's alleged money laundering—, to settle down the IPDN abuse case, and to reshuffle the current cabinet.

Nonetheless, it remains tough for president SBY to improve his image and popularity, since his opponents have clearly challenged him by means of raising the issues of illegal fund transfer from Ministry of Marine and Fishery (*Departemen Kelautan dan Perikanan/DKP*) and from the US government aimed to support SBY's presidential campaign in 2004.² Those issues also include demand for the resolution of a number of cases, such as Lapindo mud spout, and the murder of Human Right activist, Munir.

¹ <http://www.lsi.or.id/riset/218/popularitas-sby-jk-menurun-menembus-batas-psikologis>

² So far, the DKP fraud case has been controversial, whereas the case referring to Amin Rais' accusation that SBY's party had also enjoyed the illegal fund was finally closed.

THE ALLEGED VIOLENCE IN IPDN

The campus of Domestic Education Institute (*Institut Pendidikan Dalam Negeri/ IPDN*) in Jatinangor, West Java had once again gained people's attention since the demise of Cliff Muntu, the second year student coming from Manado, North Sulawesi. The IPDN claimed that it was his liver disease that took the life of Cliff Muntu, yet no one believed such claim.

Cliff's death was literally obscure. As a case in point, the corpse was intentionally admitted to Bandung's Al Islam Hospital at a time when the police conducted on-the-spot checks for the alleged violence. They were also barred by as many as fifty students when they aimed to investigate the corpse, yet it was finally taken to the Hasan Sadikin Hospital with tight security for autoption purposes.³ Police had finally found 7 marks of formalin injection on Cliff's belly, which were construed as an attempt to conceal the real causes of Cliff's demise.⁴ Based on the finding of the autoption, the death was concluded to result from brutality and torture.⁵

With the disclosure of violent practice that took the life of Cliff Muntu, IPDN's senior lecturer, Inu Syafei, after all publicly divulged all the peculiarities in the IPDN campus that have taken place

for years, such as physical torture, free sex, drugs, theft, and fight.⁶ As a result, Inu Syafei was not only protested by his students as well as his colleagues, but also requested to leave all teaching activities.⁷

In response to Cliff Muntu's case, the *ad interim* minister of domestic, Widodo AS, set up a team to investigate Cliff's demise. Based on the investigation, it was concluded that Cliff was dead due to physical torture and violence carried out by his senior fellows in the campus. Some other students claimed to be physically tortured by their senior fellows too.

After Cliff's death was publicly announced, people reacted with anger. The parliament members recommended to

⁶ According to Inu Syafei, the violence practiced in IPDN has taken the lives of at least 37 IPDN trainees. Yet, the secretary general of ministry of domestic affairs, Progo Nurdjaman, denied Syafei's claim. According to Progo, only 29 students had died and out of those 29 trainees, only three got killed due to violence. The rest died because of other different reasons, such as traffic accident, illness, or tsunami (*Koran Tempo*, 9 April 2007). Apart from the existing controversy, it was found out that during 2000-2004 a number of violations took place, such as: 35 cases of serious torture with 8 trainees being dismissed; 9000 cases of minor torture; 125 drug cases with 5 trainees being dismissed; 9500 theft cases with 18 trainees being dismissed; 150 cases of sexual abuse with 17 trainees being dismissed; 75 cases of fight; and 660 cases of free sex (*Suara Pembaruan*, 5 April 2007).

⁷ According to head of information centre of ministry of domestic affairs, the dismissal of Inu Syafei was meant to allow for easier probe of the IPDN case (*Kompas*, 11 April 2007). After the probe has been completed, Inu was allowed to teach again (*Republika*, 11 April 2007).

³ *Suara Karya*, 4 April 2007.

⁴ According to a general practitioner, the formalin may be injected only once on his foot vein and not on his tummy (*Suara Pembaruan*, 7 April 2007).

⁵ *Koran Tempo*, 5 April 2007.

close down IPDN campus or to merger it with any university under the umbrella of Ministry of Education in line with Law on National Education System. The IPDN curriculum needs to be monitored and controlled, since it has violated the Law of National Education System in which it has been under the umbrella of Ministry of Domestic Affairs (*Departemen Dalam Negeri/Depdagri*) instead of Ministry of National Education. In fact, all official training, except for military and police academy, must comply with Law of National Education System.⁸

The IPDN curriculum and education system were accused to be the root cause of violation practiced in IPDN. Some suggested the need to reorganize the management system of IPDN in dealing with the students/trainees IPDN campus.⁹ Governor of National Resilience Institute (*Lembaga Pertahanan Nasional/Lemhanas*) claimed that military system applied in IPDN should also be responsible for the violence practiced by the senior trainees. Therefore, it needs to be eliminated. According to retired minister of Justice, violence could be avoided, should IPDN have applied the education system as well as the system of controlling and monitoring the campus management in a correct manner.¹⁰ Governor of North Sulawesi planned to sue IPDN due to the demise of Cliff Muntu. Besides, members of North Sulawesi House of Representatives demanded the close down of

IPDN.¹¹ The publicly announced death of IPDN trainee, Cliff Muntu, indispensably has led other governors to stop sending any more trainees to IPDN. Some also suggested the need to audit the IPDN budget and postpone the disbursement of 2007 budget amounting to IDR 150,8b allocated to IPDN.¹²

Public strong reactions toward violence practiced in IPDN have caused President SBY to get involved in the resolution of the problem. He firmly proposed 6 steps to reorganize IPDN: (1) investigation and law enforcement upon Cliff Muntu's case must be carried out and he demanded legal sanction toward those who were proved guilty of the violence.; (2) IPDN should postpone the admission for the 2007-2009 student intake; (3) students' activities, known as Wahana Bina Praja, must be freezed either internally or externally; (4) Fostering system should be reformed and reorganized; (5) Extra-curricular activities, both internal and external, must be totally monitored by the IPDN institution; and, (6) a team consisting of intra department and non-department must be set up to evaluate all the system, method, fostering system, curriculum, and other activities practiced in IPDN in a thorough manner.¹³

Following the presidential instruction, Minister of Domestic Affairs had terminated IPDN incumbent rector's term of office to be replaced by Dr. Johanis Kaloh functioning as an ad interim rector. The

⁸ *Suara Karya*, 10 April 2007.

⁹ *Kompas*, 5 April 2007.

¹⁰ *Koran Tempo*, 5 April 2007.

¹¹ *Kompas*, 12 April 2007.

¹² *Koran Tempo*, 12 April 2007.

¹³ *Suara Pembaruan*, 13 April 2007.

legal process of Cliff Muntu's murder case proceeded. Out of 11 senior students who were arrested for the violence, seven were discharged dishonorably and respectively obliged to return the scholarship amounting to IDR 13m.¹⁴ IPDN's Dean of Government Management Faculty, Lexie M Giroth, was suspected of forging document. Another IPDN personnel was also suspected of injecting formalin to the victim.¹⁵ At the same time, the legal process was performed to investigate the case of Wahyu Hidayat's death in 2003 due to violence conducted by IPDN senior students. Ten IPDN graduates, who are now working as civil servants, were suspected of committing violence victimizing Wahyu Hidayat and consequently were fired.¹⁶

Having been evaluated by the team led by Ryaas Rasyid, it was concluded that the main problems of IPDN originated from inappropriate leadership, institutional management, and education system. Subsequently the team recommended three options: (1) allowing IPDN to remain existing on condition that the system is totally changed, no longer in the form of on duty training. The recruitment and treatment system must be reformed and the name of IPDN and its curriculum should be changed; (2) establishing Interior Government Academy (*Akademi Pemerintahan Dalam Negeri/APDN*) in 5 regions to accommodate trainees coming from 33 provinces;- (3) Providing pure on

duty training in compliance with Law No 20/ 2003 on National Education System, i.e., allowing only S-1 graduates to take non-degree program at Government Science Institute (*Institut Ilmu Pemerintahan*).¹⁷ According to Ryaas Rasyid, the implementation of these recommended options would guarantee the elimination of violence practiced in IPDN.

IPDN case is not merely caused by factors, such as violence, death, and other violations including inappropriate system and curriculum applied in that institution. What is interesting for the public is the fact that IPDN stays 'untouchable' in spite of the existing violations. The questions are: Who are backing up IPDN? Are there any vested interests taken from IPDN's existence? From the perspective of political economics, the large amount of budget allocated for IPDN deserves demand for audit. In addition, reforming IPDN system and curriculum entirely as recommended by the evaluation team can also be considered appropriate.

Amidst the effort to reform IPDN, it is necessary to question why the IPDN case is raised only recently under SBY-JK administration while in fact all the violations in IPDN have taken place since a long time ago. Yet, with this question in mind, it is hoped that the current investigation, evaluation, and legal process of IPDN case have been performed purely based on justice, not on short-term political interests.

¹⁴ *Suara Karya* 9 April 2007.

¹⁵ *Kompas*, 19 April 2007.

¹⁶ *Suara Pembaruan*, 24 April 2007.

¹⁷ *Kompas* 25 May 2007.

DISCRIMINATION IN DEALING WITH CORRUPTION CASES

The existing issues on the handling of corruption cases remain the main focus of public attention for the last half of SBY-JK term of office. People still expect SBY's seriousness in resolving the corruption cases justly. The government is considered discriminating in managing the existing widespread corruption practices. The corruption cases handled by the government are considered full of political nuances rather than justice. Corruption cases with vivid sign of legal infringement seem to be even ignored. Hence, SBY's policy in eliminating corruption practices could be like a knife with two blades: either improving or degrading his image.

The most outstanding corruption cases currently raised were Bulog gate and Tommy Soeharto's illegal fund deposited in Europe involving retired ministers, Hamid Awaluddin and Yusril Izha Mahendra.

Corruption Case in Bulog

The bad image of state-owned logistics venture (*Badan Usaha Logistik*/BULOG) remains prevalent after Widjanarko Puspoyo, the head of Bulog, was suspected of corruption and put into Cipinang jail.¹⁸ The case stemmed from the fraud committed jointly by Bulog, PT

Lintas Nusa Pratama (LNP) and PT Surya Bumi Manunggal (SBM) in the project of procuring 22,000 cows from Australia in 2001. The procurement was intended to anticipate the increased demand for meat during Lebaran, Christmas, and New Year eve. Yet, it turned out that the project was fictitious, whereas its payment had been debited from the government account.¹⁹

In that case, Widjanarko had enjoyed IDR 11b at the expense of government account. Bulog had transferred IDR 5.7b to PT LNP's account for the procurement of 1150 cows and the remaining IDR 4.9b to PT SBM for the procurement of 1000 cows.²⁰ Even though he was willing to return the money to the government, he could not get rid of the legal sanction for the crime he committed.²¹

After the thorough process of investigation conducted in his residence and his office, Widjanarko was found guilty of other corruption cases committed during the period of 2002-2005. Those cases involving a huge amount of money related to rice import, the building of Bulog office, fund transfer to a political party, and graft from the procurement of Bulog commodities.²²

¹⁹ *Media Indonesia*, 21 March 2007.

²⁰ *Media Indonesia*, 21 March 2007.

²¹ According to Widjanarko's lawyer, his client was even the victim of scam committed by PT LNP and PT SBM. Widjanarko had even taken a correct legal action by reporting those two companies that had inflicted a great loss on the government to the police (*Bisnis Indonesia*, 16 March 2007).

²² *Bisnis Indonesia*, 24 March 2007 and *Koran Tempo*, 24 March 2007.

¹⁸ In addition to Widjanarko, Bulog's other officials—Tito Pranolo, Imanusafi, Ruchiyat Subandi, Nawawi and MR Mikaramba were also put into jail (*Koran Tempo* 15 March 2007).

In the case of alleged fraud dealing with rice import, Widjanarko was suspected of receiving illicit fund from Vietnam Southern Food Company (VSFC) amounting to US\$ 1.555m. The fund was deposited in the account of President Director of PT Tugu Dana Utama. Out of the total amount of the illegal fund, as much as US\$ 1.2m was placed in the account of PT Arden Brigda Investment (ABI) belonging to Widjanarko's brother at Bukopin Bank, whereas the remaining fund was split between Widjanarko's wife, Widanarko's younger son, and Widjanarko himself in which they received US\$ 109,470, IDR 3,809b and US\$ 30,000 respectively.²³

Since Widjanarko led Bulog, his asset had multiplied implausibly in the form of houses and land scattered in different places, including cars and money. The legal process probing the illegal case of rice import has proceeded in which Widjanarko's wife, his sons, daughter, and son-in-law, including his younger brother and his concubine have been investigated. All the deposit accounts of Widjanarko's family have been freezed and his assets were already confiscated. Another fraud committed by Widjanarko was nonperforming loan for the procurement of rice drying machine in East Java involving Bank Bukopin. In that case, government had lost as much as IDR 65b. Widjanarko was finally fired and Bulog's board of directors were also replaced.²⁴

²³ *Republika*, 7 April 2007 and *Media Indonesia*, 12 April 2007.

²⁴ *Kompas*, 22 March 2007

In spite of all the efforts the Government has seriously made, it remains necessary for the Government to scrutinize other cases more intensely, such as illegal transfer to certain political parties.²⁵ The probe has not yet been focused on such fraud. The government needs to convince publicly that their serious efforts in combating deep-rooted corruption are genuinely aimed to abolish that practice on legal basis, and not aimed for short-term political purposes. It is indeed a big challenge for SBY-JK administration.

Tommy Soeharto and BNP Paribas

Former Presiden Soeharto's golden son—Tommy Soeharto—is again in the spotlight after his company—Garnet Investment Limited of Trident—filed a suit the Banque National deParis and Paribas (BNP Paribas) located in Guernsey, United Kingdom. BNP Paribas was prosecuted after refusing to release EU\$36 million that Tommy claimed to be his possession. BNP assumed the money in the bank was obtained from corruption practices in Indonesia.

The Guernsey court had finally invited the Indonesian government as third party in this case. Based on its vested interest, the government attempted to 'secure' Tommy's fund deposited in BNP. Marty Natalegawa—Indonesia's ambassador to Britain stated that the money in Tommy's account is beneficially owned by the

²⁵ *The Jakarta Post*, 26 March 2007 and *Koran Tempo*, 7 April 2007

Republic of Indonesia because it was obtained by abuse of power during Soeharto's presidency.²⁶ Tommy was also belief to have a significant amount of debt to the country.²⁷ Therefore, the Indonesia government requested the Guernsey Court to temporary freeze Tommy's fund until it can be proven that the money is not accumulated from illegal practices. The court finally fulfilled the government's request.

A more interesting case with Tommy Soeharto and his fortune in BNP Paribas occurred in 2004 when a sum of US\$ 10 million was released. Similar with the above case, this sum of money was questioned whether it was corruption-free. The released of the money was made possible with the help of former State of Secretary Yusril Ihza Mahendra and the former Human Rights Minister Hamid Awaluddin.²⁸ Yusril even guaranteed that the money was legal.²⁹

Oddly, the money was transferred using the government's Justice and Human Rights Ministry Account. According to both Yusril and Hamid, they have informed about the transfer of money to the government's account to the Attorney General's Office, Bank Indonesia and the

Department of Finance. Strangely, the Minister of Finance–Sri Mulyani Indrawati claimed that the Department of Finance has never given the permission to use the government's account. Sri Mulyani has never even received the letter of permission to use such account.³⁰ Similar with Sri Mulyani, the Attorney General, Abdul Rahman Saleh has also dismissed the claims that the Attorney General Office has issued an approval for the money transfer.³¹

In any way, according to the State Finance Investigator (BPK) the used of the Justice and Human Rights Ministry account to release Tommy's money was considered unethical and unmoral.³² In addition, the Indonesia Corruption Watch (ICW) also stated that the transfer has violated Law No 25 2003 on Money Laundering.³³

As a result of this case, there was demand from the public to probe into Tommy's funds. President Susilo Bambang Yudhoyono was also to form a special team to recover the assets of Tommy Soeharto as suggested by the Indonesian Corruption Watch (ICW).³⁴ Presiden Yudhoyono was further pressured to take legal action against former State Secretary Yusril Ihza Mahendra and former Human Rights Minister Hamid Awaluddin for helping Tommy Soeharto make a questionable money transfer. There was also

²⁶ *The Jakarta Post*, 24 January 2007.

²⁷ A few of Tommy's Soeharto 'problematic companies' were PT Timor Putra Nasional, Simpati Airline and BPPC (Colve Company). *Koran Tempo*, 26 January 2007

²⁸ At that time both Yusril and Hamid were the former Minister of Justice

²⁹ *Media Indonesia*, 6 March 2007 and *The Jakarta Post*, 9 March 2007

³⁰ *Bisnis Indonesia*, 8 March 2007

³¹ *Media Indonesia*, 8 March 2007

³² *Kompas*, 30 March 2007

³³ *Kompas*, 5 April 2007

³⁴ *The Jakarta Post* 5 April 2007

demand to remove both ministers from the cabinet.

Amidst the pressured to take legal action against the two former ministers, it was rather bizarre that Vice President Jusuf Kalla defended Hamid Awaluddin's act in helping the transfer. Kalla even stated that the money was legal.³⁵ According to ICW, Kalla's statement on the 'status' of Tommy's money has preceded the process of investigation.

Obviously Tommy's case is political in nature. Yusril and Hamid seem to be protected by 'a strong political fortress', one of it is by the Vice President himself. This has placed President Yudhoyono in such a difficult situation. The demand to remove Yusril and Hamid from the cabinet has emerged again during the discourse on the cabinet reshuffle. This time President Yudhoyono was able to make the decision to remove Hamid and Yusril from the cabinet. It seems that he was using this case to increase his reputation amidst his degrading popularity. Current development of the case has shown Tommy Soeharto's appeal towards the decision made by the Guernsey Court of the temporary freezing order of Tommy's money at the bank.³⁶

THE DECLARATION OF ULAMA NATIONAL AWAKENING PARTY

A new Muslim-based party, Ulama National Awakening Party (*Partai Ke-*

bangkitan Nasional Ulama/PKNU) was declared on 31 March 2007 at Langitan, Tuban, East Java. A number of Nahdatul Ulama's (NU's) senior cleric (*kyais*) played a pivotal role to the birth of the new party³⁷. They are influential figures in their respective local regions. Those regions were political-based party of National Awakening Party (PKB), a party that was declared by KH Aburrahman Wahid (Gus Dur), together with other NU *ulamas* and politicians in the 1999 and 2004 elections. The new born party PKNU is considered as a split off from the PKB because PKNU was declared by NU *ulama* who had also established PKB. PKNU and PKN shared similar background. They were born out of NU community. Both of their political bases rely on mass support from NU, mostly concentrated in Java.

The birth of PKNU was related to political disappointment among a number of NU senior *ulama* on the PKB. The Chairman of Majelis Syuro (Consultative Council) of PKNU Aburrahman Choudori, for example, explained that though a number of NU *ulamas* had supported the PKB, they abandoned their political support to the PKB because the party failed to accommodate the political interests of *ulamas* (Sinar Harapan, 4 April 2007). Moreover, NU senior *ulamas* regard that PKB has become a secular party (Media Indonesia online, 20 May 2007). The birth of the PKNU is also spurred by internal conflict in the PKB. The conflict

³⁵ *Koran Tempo*, 24 Maret 2007

³⁶ *Jawa Pos* 17 July 2007

³⁷ PKNU was launched by a number of NU's senior *ulamas* at Langitan, Tuban, East Java.

has divided PKB into two factions. The first faction was led by Muhaimin Iskandar and supported by former president Gus Dur, and the other was led by Choirul Anam. The latter, Choirul Anam, has formed the PKNU with the support of mainly East Java based NU senior *ulamas*.

The chairman of PKNU Choirul Anam claims that the new born party has established 33 regional chapters at the provincial level and 200 local branches at the regency (*kabupaten*) level throughout the country. With the support of such an institutional framework, the party has targeted to win 18% of the vote in the 2009 legislation election. Will the birth of PKNU bring serious challenge to the PKB in the election? A lot of political parties maintained their political support from NU, such as Partai SUNI, PNU (Partai Nahdatul Ummah), PKU (Partai Kebangkitan Ummat). But no parties roused above the PKB for winning political support of NU in the elections. Azyumardi Azra regarded that PKB was a par excellence party of NU (*Jaringan Islam Liberal*, 12 August 2001). Organizational support of the NU as the biggest mass socio-religious organization, as well as institutional networking, and figure of leadership are significant aspects for the PKNU and other Muslim-based parties in challenging PKB as a par excellence party of NU. Another crucial aspect of the PKNU, as well as other new born parties, is unfavorable trend of Indonesia's changing electoral politics along with the increasing requirement of threshold.

CABINET RESHUFFLE

President SBY finally announced the second cabinet reshuffle of his administration on 7 May 2007. The reshuffle revamped seven ministerial posts: (1) Minister of Justice and Human Right Hanid Awaluddin was dismissed and replaced by a Golkar senior politician and chairman of Golkar legislative faction Andi Matatalata; (2) Minister/state secretary Yusril Izha Mahendra was discharged and replaced by Hatta Radjasa, the former Minister of Transportation; (3) Minister for State Enterprises Sugiarto was sacked and replaced by Sofyan Djalil, the former of Minister of Communication and Information; (4) Minister for Development of Disadvantaged Regions Saifullah Jusuf was replaced by politician Mohammad Lukman Edy, the secretary general of National Awakening Party (PKB); (5) Attorney General Rahman Saleh was replaced by Hendarman Supanji, former Deputy Attorney General, and head of Corruption Eradication Team; (6) Djusman Syafei Djamal, former president of the state-owned aircraft manufacturer PT Dirgantara Indonesia and member of the National Transportation Safety and Security Evaluation team was named to fill the post of Minister of transportation, formerly held by Hatta Radjasa; and, (7) Former counselor of Surabaya Institute of Technology Muhammad Nuh was appointed to fill the post of Minister of Communication and Information.

The second cabinet reshuffle raised a critical question, especially on the main

reason beyond the revamp. Public didn't pay much attention to the reshuffle as a critical issue, especially after the president took a line up cabinet in 2005. Though Sby-Kalla administration received escalating political pressures along with its controversial policies, such as oil prices and rice import, following worsening socio-economic condition, such as widely spread of endemic diseases, transportation disaster, earth quake, unemployment and poverty—cabinet reshuffle was not a crucial issue to the public. Conversely, reshuffle cabinet become a hidden agenda among political elites, especially along with the nearing elections in 2009.

Political interests are the most significant phenomena beyond the cabinet reshuffle. Golkar party, for example, systematically promoted the reshuffle. It goes without saying that Golkar party has deep interest in it. Under presidential system, reshuffle is the prerogative of president. Unfortunately, in the country with unstable multi-party system, reshuffle was hardly taken place without considering political power in the parliament. Even though the first elected President SBY has strong legitimacy, but he was nominated by a small party (the Democratic Party). Such a situation has forced him to join power-sharing (coalition) with other parties to stabilize his government. In maintaining the coalition with other parties, political bargaining always plays significant aspect. Reshuffle, therefore, is a means not only to promote a better per-

formance of government, but also to accommodate political interests among the parties in maintaining the coalition.

The reshuffle has also become a political momentum for SBY-Kalla in recovering the declining reputation of the government. The most critical issue amidst the country's changing politics is the rampant practice of corruption. The government has launched its political agenda in combating corruption. A number of institutions and practices have been promoted in fighting against corruption, such as Commission of Corruption Eradication (KPK), Joint Team for the Eradication of the Criminal Act of Corruption (TGPTKP), and Criminal Corruption Act Eradication Team (Timas Tipikor), and a number of high profile graft cases have been prosecuted. Many high-rank state officials who committed criminal act had been put to jail. The government's commitment in fighting against corruption, however, doesn't bring practices of corruption to an end. Ironically, practices of corruption are still rampant and they wide-spread to local government levels. The opponent argued that the government keeps on performing discriminative practices in prosecuting corruptors. In this case, the dismissal of Yusril and Hamid as mentioned above amidst the mounting public pressure when they were both implicated in graft cases—has become a momentum to Sby-Kalla in winning back the government's high-profile reputation and public confidence.

REVIEW OF ECONOMIC DEVELOPMENT

Indonesia's Economy: Improving, But At A Mere Snail Pace

Deni Friawan

ECONOMIC GROWTH

IN THE first quarter of 2007, Indonesia's economic performance was improving albeit only slowly. The economy grew by 6.0%, higher than both first quarter of 2006 (5.0%) and the average growth of 2006 (5.5%), but still lower than 6.3% of government target in 2007. This growth was associated with an increase in export due to high increase in commodities prices in international market and also the persistent increase in household consumptions that were traditionally the highest contributors of Indonesia's Gross Domestic Product.

Expenditure Side

On expenditure side, consumption continued to increase. In the first quarter of 2007, the household consumption grew by 4.5% (y-o-y), higher than in the first and fourth quarters of 2006, which were 2.94% (y-o-y) and 3.76% (y-o-y) respectively. As the inflation stabilized and the interest rate declined continuously, non-

food consumption rose substantially and contributed significantly to the overall house consumption growth.

Meanwhile, the investment growth showed a sign of improvements, although remained weak. The investment grew by 7.5%, a high growth compared to 1.1% in the first quarter of 2006. In contrast to the fourth quarter of 2006, however, the investment growth in first quarter of 2007 was still lower than 8.2% of the fourth quarter of 2006. The declined investment in the first quarter of 2007 compared to that in the fourth quarter of 2006 was mainly due to the reduction of investment in foreign and domestic transportation mode. While the interest rate reduction trend has contributed to an increase in investment growth, some structural weaknesses remain prevalent, which have impeded the steady increase in investment growth. Weak infrastructure and poor investment climate associated with labor issues, red tape, weak legal system, and chronic corruption have been unresolved problems that have retained the growth of foreign and domestic investment.

Table 1. Components of GDP Growth: Expenditure Side (2000 Prices; Y-o-Y)

	2005	2006				2006	2007
		Q1	Q2	Q3	Q4		Q1
Household consumption	4.0	2.9	3.0	3.0	3.8	3.2	4.5
Government consumption	6.6	11.5	28.8	1.7	2.2	9.6	4.3
Gross fixed capital formation	10.8	1.1	1.1	1.3	8.2	2.9	7.5
Change in stock	-25.7	-65.2	-43.7	-24.6	-88.6	-29.8	27.1
Export of goods and services	16.4	11.6	11.3	8.2	6.1	9.2	8.9
Less import of goods and services	17.1	2.8	7.5	10.1	9.7	7.6	8.4
Gross Domestic Product	5.7	5.0	5.0	5.9	6.1	5.5	6.0

Source: BPS

Production Side

On the supply side, almost all sectors were in the progressing trend, except for the agriculture sectors that experienced a negative growth. The transportation and communication sector and the construction sector experienced the highest growth, i.e., 11.1% and 9.3% respectively. Moreover, the manufacturing sector, the most dynamic of engines of growth in the pre-crisis period, started to show a moderate improvement, raising optimism on the economic prospect in 2007.

Total manufacturing sectors grew by 5.4%, while non oil and gas manufacturing sector increased by 5.8%. In the latter sector, while wood products and other wood products sector were continuously experiencing negative growth by -1.7%, the paper and printing sector as well as the food, beverages and tobacco sectors have experienced the highest expansion, i.e., 12.5% and 9.8%. The flood disasters that occurred in February seems to have only little impact on the economic growth

in the first quarter of 2007 as well as the prospect of economic growth in 2007.

OUTLOOK FOR 2007

Although many problems, particularly those related with regulatory and bureaucracy, have still remained, a sensible optimism should be considered. Since many macro-economic indicators displayed a positive progression, the consumption and investment are expected to increase in 2007. In the first half of 2007 the economy remained mainly driven by an increase in private consumption as a result of the rise in civil servant salary and the increase in regional minimum wage levels. Meanwhile, the private investment and government capital expenditures are expected to take part in promoting economic growth in second half of 2007 when the ministries and government agencies start their development projects and the rising confidence of economic participants in the growth outlook and the downward trend in

Table 2. Components of GDP Growth: Productions side (2000 Prices; Y-o-Y)

	2005	2006				2006	2007
		Q1	Q2	Q3	Q4		Q1
Agriculture	2.7	6.4	1.5	2.2	1.8	3.0	-0.5
Mining and Quarrying	3.1	2.7	4.0	1.6	0.7	2.2	5.6
Manufacturing, petroleum & gas	4.6	2.9	3.7	5.9	5.9	4.6	5.4
Manufacturing, excl petroleum & gas	5.9	4.0	4.3	6.9	5.8	5.3	5.8
Electricity, Gas, and Water	6.3	5.1	4.5	5.8	8.1	5.9	8.2
Construction	7.4	7.4	8.7	9.3	10.4	9.0	9.3
Trade, Hotel, and Restaurant	8.4	4.4	5.5	7.5	7.0	6.1	8.5
Transportations & Communication	13.0	11.5	13.5	13.6	15.9	13.6	11.1
Financial, Ownership & Business	6.8	5.7	5.3	4.7	6.8	5.6	7.1
Services	5.0	5.8	6.1	6.8	6.0	6.2	7.0
Gross Domestic Product	5.7	5.0	5.0	5.9	6.1	5.5	6.0

Source: BPS

domestic interest took their effect in the form of the realization of their investment plan. Nevertheless, the export is likely to decrease due to the decline in expected global economic growth and predicted commodities prices. The prospect of world economy is expected to decline due to the continuation of the implementation of gradual tight monetary policy started in 2006 and the fiscal consolidation in some countries, including China and India, oil price which is still quite high, and the worry about slowdown in US economy.

MONETARY DEVELOPMENT

The monetary authority continuously maintains its loose monetary policies in the first quarter of 2007. The constant decline of inflation rate from 6.6% (y-o-y) in the end of 2006 to 6.5% (y-o-y) in the

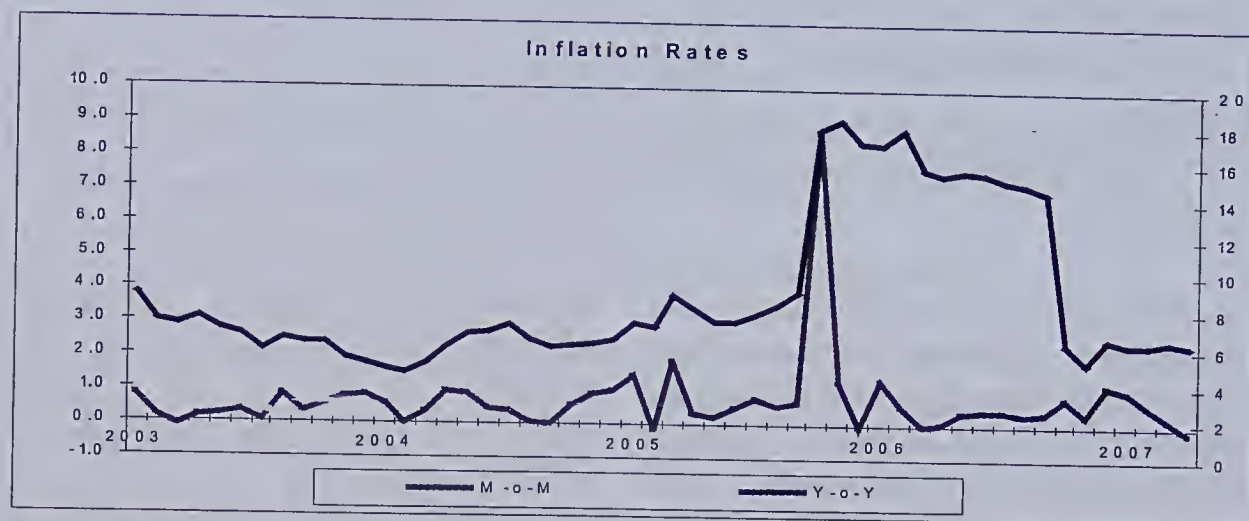
last month of first quarter of 2007 provide the Central Bank of Indonesia more room to further cut the SBI rate. Between January and March 2007, the monetary authority has executed three times interest rate reduction from 9.75% in the end of 2006 to 9.0% in the last month of first quarter of 2007, or totally accounted 75 bps (basis points). Meanwhile, improvement in macro-economic fundamental resulting from manageable Indonesia risk factors and attractive return on assets denominated in rupiah have encouraged a massive inflow of foreign portfolio investment to Indonesia, and thus generating a substantial appreciation of rupiah as well as a considerable increase in the stock market index. By the end of the first quarter of 2007, the rupiah appreciated to Rp 9,118 per US\$ and the Jakarta stock exchange composite index increased to 1,830.9.

Inflation

During the first quarter of 2007, the inflation rate kept at a low rate; and deflation even took place in April. Annual inflation increased from 6.3% in January to 6.5% March, but then declined to 6.3% in April. In the meantime, the monthly inflation decreased from 1.04% in January to -0.16% in April, extending its declining

trend since the last month of 2006. The appreciation of rupiah, the moderate increase in aggregated demand, the sufficient supply of some food products, and the effectiveness of government policies in maintaining administrated priced and sound monetary policy have stabilized the inflation rate and kept it near to government's target of 6.5%.

Figure 1. Inflation Rates



Source: BPS

In all three months of the first quarter of 2007, the increase in the prices of foods, and housing and utilities continued to be the main source of inflation. Similar to the first quarter of 2006, the food prices continue to rise, particularly in January which contributed 0.7% to total inflation, even after the festivities were over due to the increase in the price of rice, as a result of a combination of harvest delayed

caused by the delay of rainy seasons, distribution bottleneck, and controversies over rise import. Afterwards, however, as the controversies over rise import was over, distribution problems have been solved, and the harvest session had begun in February, the increase of food prices was slowing down and even experiencing deflation in April, contributing -0.4% of total inflation -0.16%.

Table 3. Contribution of Expenditure Groups to Total Inflation, Dec 2006-April 2007

	Dec-06	Jan-07	Feb-07	Mar-07	Apr-07
Food	0.8	0.7	0.2	0.1	-0.4
Processed food, beverages, cigarettes	0.2	0.2	0.1	0.1	0.1
Housing and utilities	0.2	0.2	0.2	0.1	0.1
Clothes	0.0	0.0	0.0	0.0	0.0
Health	0.0	0.0	0.0	0.0	0.0
Education, recreation and sports	0.0	0.0	0.0	0.0	0.0
Transport, communication and financial services	0.0	0.0	0.0	0.0	0.0
Total	1.2	1.0	0.6	0.2	-0.2

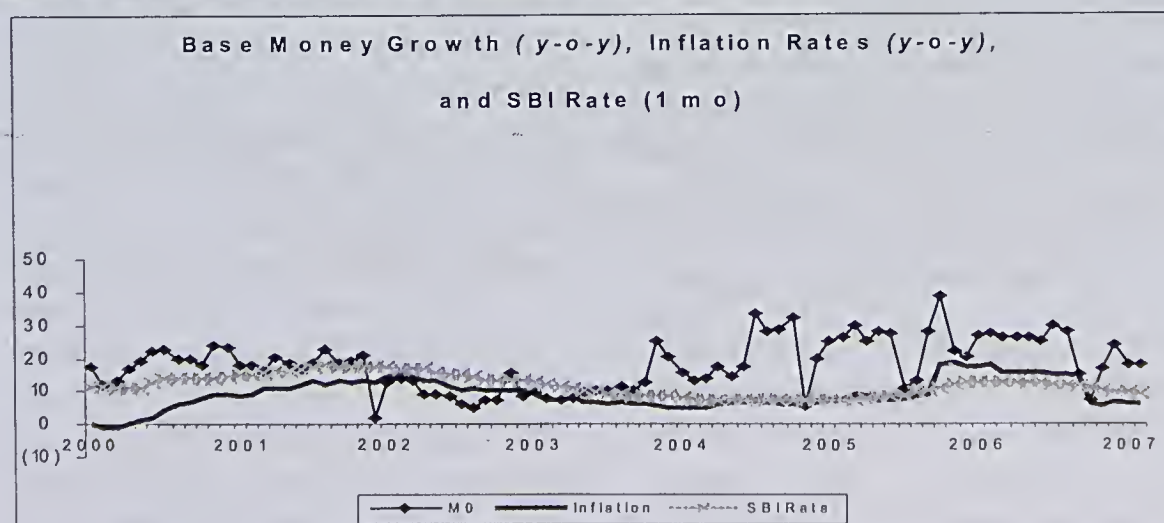
Source: BPS

Money Supply and Interest Rate

With the inflation well in check and exchange rate slowing down, the monetary authority is granted a wider room to carry on its unfastened bias as reflected in a significant increase of money supply and considerable decline of interest rate. Compared to that at the end 2006, the base money fell by Rp 297.4 trillion to Rp 272.2 trillion at the end of the first quarter of 2007, while the 1-month

Sertifikat Bank Indonesia/ SBI declined by 75 bps (basis points) to 9%. Meanwhile, as the nominal interest rate continues to decline and the inflation rate remains above 6%, the decline in the real interest rate was quite significant. The real interest rate decreased from 3.24% in January 2007 to 2.48% in March 2007. This declining trend of real interest rate is expected to continue in several months ahead as the Bank Indonesia seems to continue its loose bias of monetary policy.

Figure 2. Base Money Growth, Inflation Rates and BI Rate



Source: Bank Indonesia

In the mean time, parallel with the decline of SBI rate, other interest rates, including the lending rate, also followed to decrease. During the first quarter of 2007, the nominal working capital rates declined by 0.58 bps to 14.49%, although it is still quite high, above 14%. As a consequence, the credit growth has increased steadily, albeit at slower pace. The credit growth rose from Rp 787.1 trillion in the fourth quarter of 2006 to Rp 794.7 trillion in the first quarter of 2007.

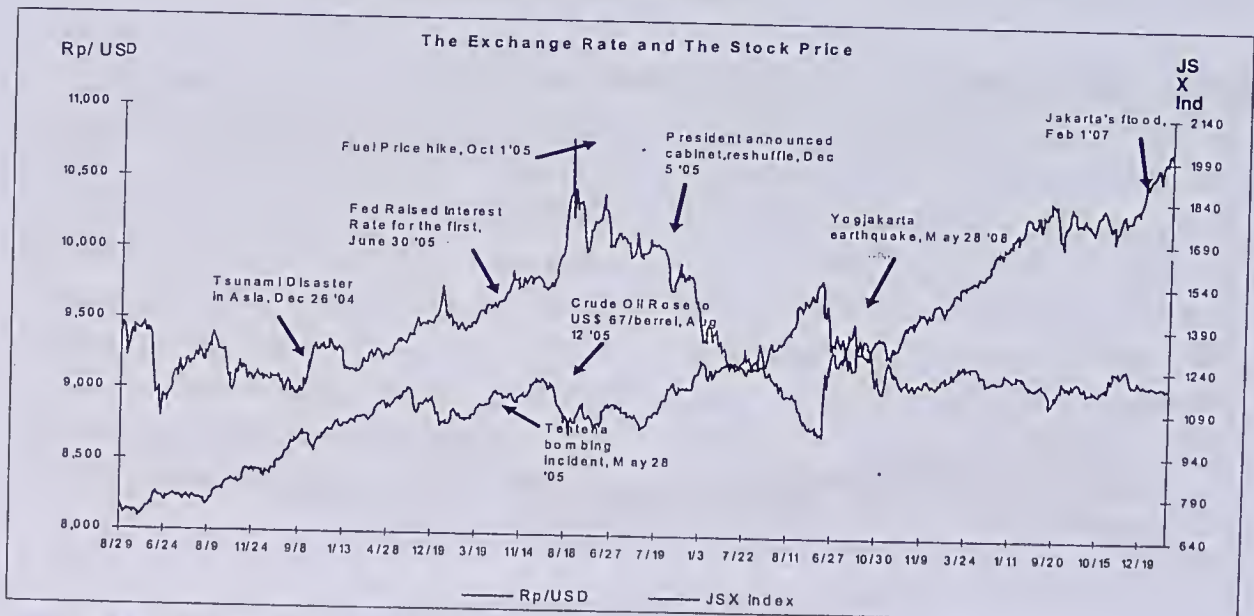
Exchange Rate and Stock Market

Benefiting from the huge inflow of foreign portfolio investment, the rupiah continues to show a stable movement and an appreciating trend. The rupiah fluctuated around Rp 9,225-8,950 per US\$ during the first quarter of 2007 and reached its highest level of Rp 8,815 per

US\$ in May 30th, 2007. Internal pressure from the interest rate decline and external pressures from Thailand's move to impose tighter restrictions on capital inflows as well as the improvement of US economic indicators seemed to have a little effect on the rupiah.

Along with the decreasing trend of interest rates, the enormous of capital inflow resulting from combined excess liquidity in global financial market and attractive return on assets denominated in rupiah generated a dynamic movement of the Jakarta Stock Exchange (JSX) Index. The JSX Index hovered around 1,698.8 to 1,836.5 during the first quarter of 2007 and strengthened significantly, hitting an all-time high passing the psychologically important level of 2,000 on 26 April 2007. This was driven by gains across Asian markets and an increase of 75 bps in

Figure 3. The Exchange Rate and the Stock Price



Source: Bank Indonesia and CEIC database

interest rate succeed to counter the negative sentiments from the implementation of capital control in Thailand, the special inspection of illegal activities in China stock market, and the increasing trend of non performing loan in US housing industry.

Prospects

Looking ahead, while the inflation has been well checked, some internal and external pressures may still remain. Although Indonesia government has been committed to retain the price of electricity rates, and fuels eliminates the inflationary pressures from administered goods, the prospect of an increase in domestic demand resulting from low interest rate and improvement of income and the shortages of some staple foods, particularly rice and cooking oil, give a tension for general price to increase slightly above the government inflation target of 6.5%. Facing this kind of possibility, the central bank of Indonesia (BI) probably will take a neutral monetary policy and the BI rate is targeted to be at around 8.5-9.0%.

Meanwhile, the continued surge inflow of foreign capital is predicted to occur in next few months, due to good prospect of Indonesia economic outlooks, persistence of excess liquidity in global financial market and attractive return of asset denominated in rupiah. However, most of the capital inflow is believed to be short-term funds that may create pressure on the rupiah. Nonetheless, in the short run, we expect the rupiah could test below Rp 9,000 before hovering around 9.000-9300 in the near future.

BALANCE OF PAYMENT

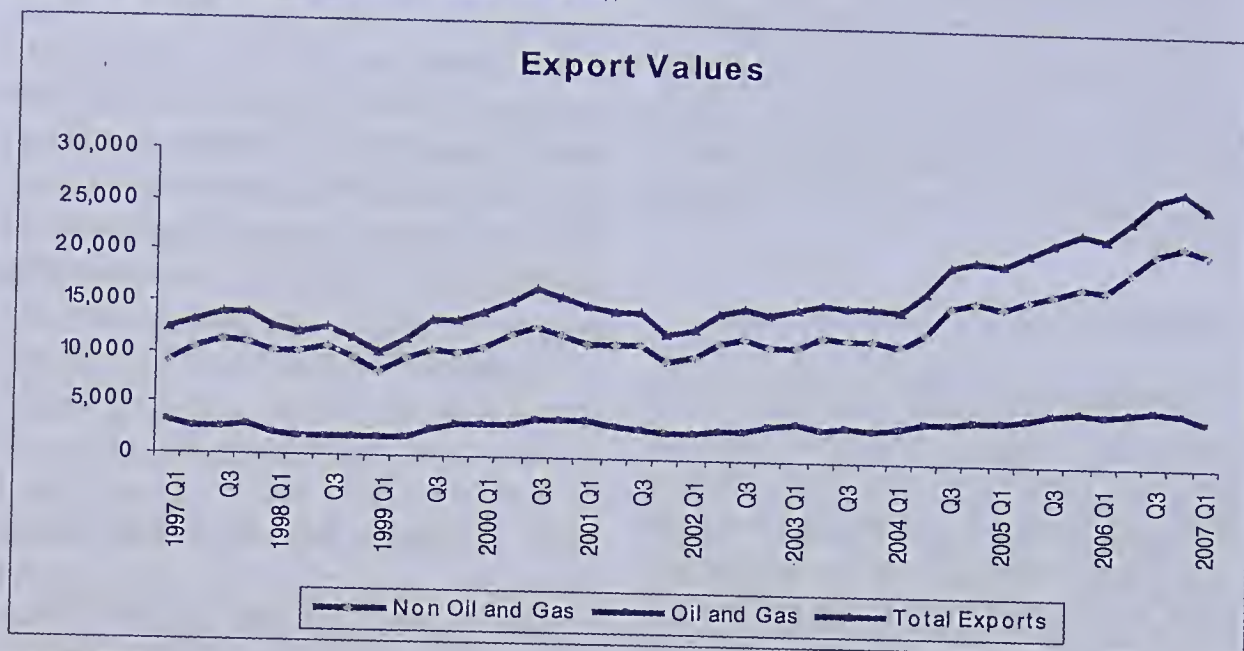
Compared to 2005, both Indonesia's export and import increased in 2006. The export rose from 85.6 billion in 2005 to 100.8 billion in 2006, or increased around 17.7%, while the import increased from 57.7 billion in 2005 to 61.1 billion in 2006, or rose about 5.8%. As consequence, the net export in 2006 reached US\$39.7 billion, an increase of 42.1% compared to the previous year. Considering the high level of total net export and its growth compared to those in the service and income balances, we expect that the current account surplus in 2006 will be higher than in the preceding year. Similarly, we also expect that the capital account improve considerably due to a massive surge of port-folio investment.

Export and Import

The first quarter of 2007 witnessed a notable increase in trade performance. While oil and gas export decrease by 11.9%, the manufacturing export increased by 22.3% resulting in an increase of total export to the level US\$25.7% or increased by 14.5% (y-o-y) as compared to the same period in 2006. The significant increase of Indonesia's export was caused by combination of high increase in commodities prices, and the continuous economic expansion of Indonesia's major trading partners and global economy.

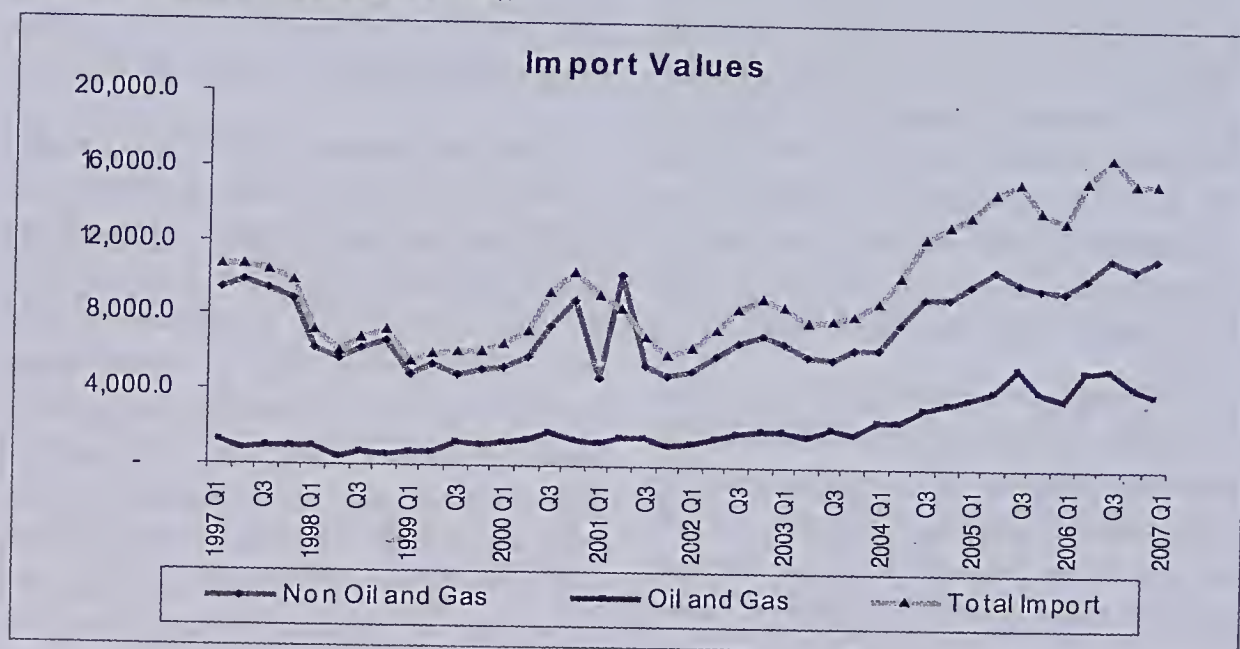
Machinery and electricity equipments remain to be the largest manufacturing export commodities, accounting about 8.7% of the total manufacturing exports. In the meantime, Japan, US, and Singa-

Figure 4. Export Values (millions of US\$)



Source: BPS

Figure 5. Values (millions of US\$)



Source: BPS

pore continued to be Indonesia's largest export destination, contributing around 37.2% to Indonesia's total non-oil exports.

Similar to Export, the Indonesia's import also increased in the first quarter of 2007. During the first quarter of 2007, total imports grew by 15.4% (y-o-y), and reached US\$15.4 billion. The raw material/auxiliary goods accounted around 76.8% of Indonesia's total imports, the consumptions goods grew by 15.9% and 28%, while the capital goods import increased only 4.3%, which may raise concern on the prospect of Indonesia's export in the coming months.

Current Account

The sharp increase of export generated a higher trade surplus in 2006, which was confirmed by Bank Indonesia preliminary figure of 2006 trade balance. Throughout 2006, the trade balance was around US\$29.7 billion, or approximately 69.5% higher than that in 2005. Eventually, although there was an increase in import of services by around US\$2.1 billion and income payment abroad by about US\$0.8 billion, the considerable increase in net export brought increase in current account surplus by US\$9.3 billion to reach US\$9.6 billion in 2006, higher than the level of 2005, which was only less than US\$0.3 billion.

Capital Account and FDI

The year 2006 also witnessed the similar figure in the capital account. The primary figure of capital flow shows that the capital continues to flow into the

country. The capital account surplus attained US\$2.5 billion, or increased around 7 times compared to a net inflow in the earlier year. This is mainly caused by the increase in the net inflow of foreign direct investment of US\$4.1 billion and the steady increase of portfolio investment of US\$3.8 billion. While the high increase of portfolio investment has raised concern over deep-seated structural imbalances in the accumulation of reserves and apprehension over threat of sudden change in the sentiment of investors.

PROSPECTS

In 2007, we predict that it will be difficult for the Indonesia's export of goods and services to attain the target of 20%. There are several reasons as to why this may be the case: (1) the prediction on down ward trend of global economy; (2) the declining trend of commodities price in the global market; (3) the reduction in investment realization in 2007; and (4) the prevailing poor condition of infrastructure. On the contrary, import is expected to increase due to an increase in domestic demand, more stable rupiah, and the increasing trend of global economy. As a consequence, these trends may create a pressure to the current account in 2007.

Meanwhile, while the foreign purchases of portfolio assets may still continue in the next few months and the foreign 'greenfield' direct investments may start to improve due to a more conducive investment climate resulting from the implementation of new investment law, the capital outflow from the repayment

of loans by domestic companies may still continue. As a result, the net capital inflow will remain moderate.

OTHER ISSUES

New Investment Law Passed

On 29 March 2007, the House of Representatives (DPR) finally passed the new long awaited investment law. According to the Trade Minister, Mari Pangestu, the new law will increase investment competitiveness against regional rivals such as Singapore, Thailand and China.

The law introduces various incentives for foreign investors, including fiscal incentives as well as government assistance in land acquisition and import licensing. Foreign investors can “rent” land for 60 years, and can renew it for another 35 years. Meanwhile, incentives will be given to investments in labor-intensive and high-priority industries,

infrastructure projects, and remote areas. Incentives will also be given to investments that bring in new technologies, are environmentally-friendly, promote research, development, and innovation, utilize locally-produced capital goods, and partner with small-and-medium businesses.

The new law also elevates the status of the Investment Coordinating Board (BKPM), to that of a non-governmental institution that reports directly to the president.

In recent years, Indonesia performed poorly with regards to its investment. Investment grew by a mere 2.9% last year, compared to the economy’s 5.5% growth. According to the World Investment Report, Indonesia placed the 112th out of 141 economies. Pressing issues include the amount of time and the number of procedures needed for investment approval.

Key Incentives In The New Law:

1. Fiscal Facility, which applies to investment by limited liability companies.
2. Services for Rights of Land Use which can be provided and extended in advance, and be renewed as requested by an investor. Nevertheless, the rights will be denied should the investor does not use the land, the rights of land use is detrimental to the public interest, and the investor does not utilize the land as purportedly stated when the rights was granted.
3. Immigration Services, which can be extended to investments requiring foreign experts, and to potential investors undertaking business feasibility assessment.
4. Import Licensing Facility for goods so long as they are in compliance with the existing regulations, and those that do not result in negative impacts on safety, security, health, environment and the nation’s morale, or for relocation to Indonesia, and for meeting the needs of capital goods and raw materials for own productions.

Government 's 2008 Growth Scenario

The government set a more optimistic economic scenario for 2008 relative to 2007. According to Coordinating Minister for Economic Affairs Boediono, growth is projected at between 6.6%-6.8% in 2008, up from 6.3% in 2007. Consumption is expected to grow by 5.9%, government expenditure at 8.9%, and exports at 12.7%. Meanwhile, investment is expected to grow at an ambitious rate of 15.5%

Slower world economic growth, domestic factors like favorable business climate and oil prices might pose a risk to this optimistic scenario, particularly in relation to growth in manufacturing and export sectors. In the first quarter of 2007, investment growth at 13%, much lower than the expected 17%, also suggests that investments remain moderate. Boediono expects falling BI rates will reduce the cost of investment and promote stronger investment growth.

REVIEW OF REGIONAL AND GLOBAL DEVELOPMENT

Indonesia Confronts Strategic Regional Issues

Lina Alexandra, Edy Prasetyono and Begi Hersutanto

THE LAST three months saw major regional and international developments that have affected Indonesia's interests and shaped public debate here as to how Indonesia should respond to these developments. The issue of Myanmar has again attracted the attention of ASEAN, while the issue of Defense Cooperation Agreement between Indonesia and Singapore continued to be debated by certain sectors here in Indonesia. The region also saw Japan's move to become what many called a "normal country", a policy decision that may invite negative reactions from certain parts of the region.

ASEAN and the Issue of Myanmar

In the mid-2007, the issue of human rights violations in Myanmar has again attracted attention from the international community. After eleven-years of punishment, the Myanmar government again decided to extend the sentence for the pro-democracy activist Aung San Suu Kyi for another one year¹. The possibility for regi-

me change due to the absence of PM Soe Win and General Than Swee has strengthened the government's stance to prevent any movement which may cause any further political instabilities². Pressures from the international community upon the government in Yangon have failed to move Myanmar toward a more democratic direction.

This continuing human rights violation in Myanmar spoiled the image of ASEAN as the most prominent regional organization in the Southeast Asia region. ASEAN seems to have been unable to exert its influence upon its members in implementing the democratization process in their domestic politics. When Myanmar was accepted as a member of ASEAN in 1997, the international community actually doubted the capacity of ASEAN to push for a significant change within the Myanmar's domestic politics. ASEAN's strong adherence to the principle of non-interference and respect for sovereignty have contributed to ineffectiveness of ASEAN in casting for a more democratic Myanmar.

¹ *Kompas*, 26 May 2007

² *Kompas*, 22 May 2007

This issue of Myanmar has dragged ASEAN into oppping camps. Indonesia, Malaysia, and Philippines have been adamantly put strong pressure against Myanmar to immediately release Suu Kyi in order to restore ASEAN's image. In this case, the Malaysian Foreign Minister, Syed Hamid Albar pointed out the importance for the ASEAN member countries to put aside their national interests and unite to urge for the release of the pro-democracy activist.³ Furthermore, the Indonesian Foreign Minister, Hassan Wirajuda has call ASEAN to reflect the statement made by the ASEAN foreign ministers in Cambodia and the Head of States in Bali in 2003⁴ as their point of reference. Laos, Vietnam and Cambodia however reject such criticisms and tend to resort to interventionist policy.⁵ But, it seems that ASEAN would still hold on the non-interference principle rather than imposing a firm actions against the military junta in Myanmar. Political statements from the ASEAN leaders implicitly signified that ASEAN has shifted its strict adherence to the non-intervention principle. But, no concrete actions have so far been done to exert more pressure on the regime in Yangoon. Such reluctance can be seen from the decision not to include the issue of Suu Kyi into the agenda for ASEAN Ministerial Forum meeting which will be held at the end of July 2007.⁶

Indonesia – Singapore Defence Cooperation Agreement (DCA)

On 27 April 2007 Indonesia and Singapore signed DCA (Defence Cooperation Agreement) and an extradition treaty. The signing of the two treaties was done in Tampak Siring, Bali by Ministers for Defence, Ministers for Foreign Affairs, and Chiefs of the Armed Forces from both countries. President Susilo Bambang Yudhoyono and Prime Minister Lee Hsien Loong witnessed the signing of thse two documents.

The Defence Cooperation Agreement covers a wide range of defence cooperation between Singapore and Indonesia. It acknowledges mutual benefit of the cooperation between to the two countries and to the TNI and SAF. The aim of the agreement as stated in the Article 1 is to establish a comprehensive strategic co-operation framework to strengthen bilateral defence cooperation in the areas of professional development, operational readiness, and interoperability ththrough the use of of each other's areas and facilities on the basis of equality, mutual benefit, and respect for each other's sovereignty and territorial integrity.

Indonesia would provide Singapore with some areas to be used by the Singaporean Armed Forces for military trainings. In return, the Indonesian Armed Forces (TNI) would have direct access to Singapore's military technology and facilities. The DCA requires a ratification by the parliaments of the two countries and shall be put into force for 25 years, with a review of every 6 years after the

³ *Ibid.*

⁴ *Kompas*, 23 May 2007.

⁵ *Ibid.*

⁶ *Kompas*, 24 May 2007.

first 13 years of its implementation. The Commission I of the Indonesian Parliament has expressed their criticism, concerns and urged the government to revise DCA and to establish technical, operational, and administrative arrangements for military trainings in all areas, including that of Bravo area.

Recent debates in the last two months have demonstrated that the DCA is more sensitive than the ET. Many Indonesians are concerned about the implication of the DCA on the country's sovereignty and some have argued that it could undermine Indonesia's defence. The situation has even been more complicated further as Singapore indicated that no specific implementation arrangement was needed for SAF to conduct military trainings in Bravo area. As a matter of fact, the IA signed by the two countries does not cover operational arrangements for Bravo area. This makes Singapore to argue that with the signed IA they can directly use Bravo area for SAF military exercise. Minister for Defence, Juwono Sudarsono, said that if that should be the case, Singapore deliberately disregard the TNI. Thus, it is important that Indonesia and Singapore bring the issues to the negotiation table to address the operational aspects of the agreement and establish the details of implementation arrangements for all military training areas.

The debate and concern about the DCA signify the weakness of Indonesia's defence and its implication on the Indonesia's diplomacy. This is perhaps the important lesson that should be learned by Indonesians. Competition and coope-

ration remain the rule of the game in today's international relations which requires the development of national capacities, including armed forces, to be able to respond effectively and properly.

Developments in the Northeast Asia

The Elevation of Japan Defense Agency to the Japan Defense Ministry

On January 9th 2007, Japan Prime Minister Shinzo Abe made a significant policy towards the future status of Japan as a normal country by elevating the Japan Defense Agency, in which the management of Japan Self Defense Force was subordinated to, into the Japan Defense Ministry. This decision to have such ministry is meant to be on par with other central ministries in Japan.

The term "normal country" in this regard is referring to the alleviation on the curbing of Japan military development which has been imposed to Japan since the end of the World War II.

With regard to the normalization of Japan military development, many people have casted their doubts as well as trust to the future prospect of such political decision taken by the Shinzo Abe's administration. Many people are still traumatic about Japan's political behavior in the region during the Second World War. At that time, Japan as a small archipelagic country dared to challenge the United States armada in the pacific by attacking the Pearl Harbor. For Japan, the attack on Pearl Harbor was intended to open ways to expand its influence and

presence in Southeast Asia. Japan's military action was actually preceded by its invasion into China.

There were so many horrific stories about Japan remembered by the survivors of the World War Two, particularly from Asia. Among them are the phenomena of *romusha* (forced labor) and *jugun ianfu* (comfort women). For these, Japan for the last sixty years has been demanded by the victims of the Japanese occupation for an open apology and concession. The Japanese government already announced the apologies for at least nine times since 1971. However, an apology has never been enough. Now, with Shinzo Abe's administration decision to establish increasing Japan Defense Ministry, analysts view this phenomenon as a small but significant beginning for Japan to move towards a much stronger international posture in the future.

Perhaps it is still too early to say that Japan's move will affect military balance and the stability in the region. The first thing Japan must do before it actually puts its vision into reality is that Japan must revise the article 9th of its constitution, which prohibit military expenditure exceeding 1% of the total GDP, and prohibiting the deployment of Japan Self-Defense Force outside the country for other than humanitarian purposes.

One remembers well that during his campaign, Mr. Abe he often stated that revising article 9th of the constitution will be one of his core political platform. Now we all can see that he is seriously working to make it happen by making a small yet

significant step by elevating the Defense agency to the status of central ministry.

Interestingly, Mr. Abe stated in his speech in front of the NATO leaders on January 12th 2007, just three days after the elevation of Japan Defense Agency to Japan Defense Ministry, that his administration is discussing the best form of international peace cooperation, including a general legal framework for the participation of Japan Self-Defense Forces and civil personnel. He also clearly stated that Japan will no longer shy away from carrying out overseas activities involving the SDF, if it is for the sake of international peace and stability. In this occasion Mr. Abe also declared Japan's commitment to the stability in Iraq and in Afghanistan by sending military personnel and providing reconstruction assistance. Within such spirit, Mr. Abe also expressed the view of the Japanese government that Japan will work closely with NATO and its partners.

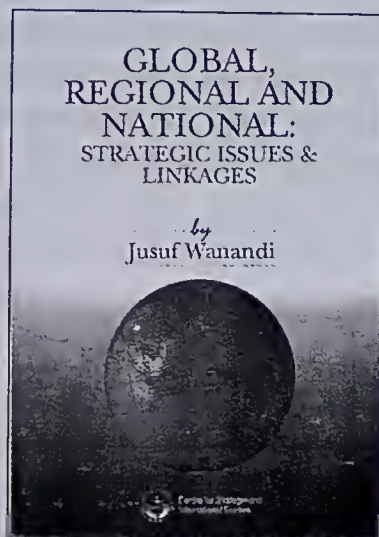
Japan-China Relations

During May 2007, Prime Minister Shinzo Abe and President of the People's Republic of China have made a historic meeting between the two of them. This meeting is a clear indication that the two leaders intended to ease up the tension between the two countries. The meeting saw not only commitment by the two leaders to ease up the tension, but also agreement to conduct cooperation between the two countries for gas exploration. This achievement showed that chances for cooperation between the two countries are

wide open, and this will hopefully reduce the tension that has had occurred in their bilateral relations. Dialogue seemed to

have been the best mechanism for China and Japan to build trust as well as to create the stability the region.

GLOBAL, REGIONAL AND NATIONAL STRATEGIC ISSUES AND LINKAGES



By *Jusuf Wanandi*

Published by *Centre for Strategic and International Studies (CSIS), Jakarta.*

This volume is a collection of the collums of Jusuf Wanandi in *The Jakarta Post*, covering over a period of over twenty years since January 1984. The collection of articles selected for this book shows the comprehensiveness of Jusuf Wanandi's thoughts. They range from international and regional political affairs to domestic developments in Indonesia. The last twenty years have been a very interesting two decades of significant in the global arena that saw the ending of the Cold War and the acceleration of the process of globalization. Significant changes also took place in Indonesia as well as in Southeast Asia and the

wider region of East Asia and Asia Pacific. These regions have entered an era that is characterized by dynamic economic interactions leading to greater independence.

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Macroeconomic Policy Reform Strategy for Regional Cooperation

Hadi Soesastro

INTRODUCTION

EAST ASIAN economies have made use of regional cooperation to advance their domestic economic reforms. But by the same token, at least in its initial stage regional economic cooperation in East Asia has also been driven by economic reforms that have been independently undertaken by regional economies.

The "first generation" economic reforms in East Asia have been characterized by measures to gradually open up the economies, initially manifested in the efforts to promote exports through various measures other than the liberalization of trade. In Korea, for example, the policy of so-called "double distortions" was the way to expand exports while continuing to seal off the economy. In such countries as Malaysia and the Philippines, export processing zones were formed to promote exports from certain production locations that were managed under special policies. China successfully invented special economic zones that encompass large

areas, even entire provinces in the coastal regions.

Trade liberalization was only a matter of time. In the case of the (original) ASEAN countries, their involvement in the Uruguay Round of multilateral trade negotiations brought home the message that to secure greater market access for their exports they too need to allow others greater access into their markets. ASEAN countries accepted the notion of "graduation" to becoming newly industrializing economies (NIEs). It was this promise of moving up the ladder of development, and of becoming members of an East Asian "flying geese" formation, that led them to adopt progressively more open economic policies. The ASEAN economies became more integrated to their neighbors in the North.

Subsequently, the ASEAN economies in particular embarked on investment liberalization to attract capital and technology in order to expand and up-grade their production capacity. ASEAN began to entertain the idea of forming a regional

production platform for the global markets. This policy coincided with the strong drive on the part of Japanese companies to migrate to the South in response to the sharp Yen appreciation following the Plaza Agreement. The strong investment pull and push factors resulted in a new, dynamic regional division of labor that became progressively more horizontal in nature. This has led to the emergence of regional production networks.

The dynamic developments in the region provided the argument for committing the countries to adopting and sustaining open economic policies as manifested in the efforts to continue with a program of trade and investment reforms. They have achieved a great deal but they continue to struggle with the problem of "sensitive sectors".

Regional cooperation has helped to strengthen the commitment to open economic policies. The ASEAN Free Trade Area (AFTA) is seen by members as a means to lock in domestic economic reforms. Vietnam has been able to promote domestic economic reforms in part by using its commitments in ASEAN as a pretext. In view of its spectacular development performance it is not surprising that Vietnam has become the main champion of ASEAN.

Regional economic integration, or "economic regionalization", in East Asia has been largely market driven. Governments have entered the picture by promoting "economic regionalism" with the adoption of agendas that focus on trade

and investment liberalization and facilitation. In ASEAN, with the formation of AFTA in 1993, the action plan has focused on the Common Effective Preferential Tariffs (CEPT) to be introduced by member economies and gradually reduced to 0-5% by a date certain. An exclusion list and a sensitive list were introduced to deal with the "sensitive sectors". An assessment of the impact of AFTA suggests that intra-ASEAN trade only increased slightly and that only about 5% of it has used the CEPT. What is often overlooked is the fact that together with the reduction of CEPT rates, ASEAN members have also lowered their MFN tariffs, making the whole of ASEAN a more open economic region for the world.

In 1994, APEC produced one of the most significant initiatives thus far, namely the Bogor Goals of free and open trade and investment in the region by 2010/2020. It is not a free trade area (FTA). Trade and investment liberalization has been pursued through the adoption of a modality known as "concerted unilateral liberalization" that is voluntary in nature, manifested in annual Individual Action Plans (IAPs). Progressive liberalization is to be achieved through peer pressure. APEC trade liberalization has been underestimated because members' commitments to reduce tariffs are seen to have come largely from initiatives outside of APEC and because the attainment of the Bogor Goals is being questioned. But APEC is about creating an environment that encourages members to maintain a strong commitment to open economic policies. In fact, average tariffs of APEC

members have declined significantly, from 16.6% in 1988 to 6.4% in 2004. Trade and investment liberalization efforts are also accompanied by trade and investment facilitation measures as well as economic and technical cooperation. They form the three main pillars of APEC cooperation. A fourth pillar, human security, has been added since 2003.

APEC is much more than trade and investment liberalization. It is about community building. However, its achievements have been measured mainly in terms of trade and investment. Although average tariffs have gone down significantly, the APEC region still faces difficulties to remove barriers in a number of "sensitive sectors". Experience now clearly shows that the real sensitive sectors, such as agriculture for a number of developed and developing countries, that are difficult to deal with multilaterally also cannot easily be removed through a regional (or bilateral) agreement. In fact, it appears that they can only be dealt with at the global level (WTO).

APEC's inability to overcome this difficulty is not due to its voluntary nature. Therefore, suggestions to transform V-APEC (voluntary APEC) into B-APEC (binding APEC), as prominently manifested in the idea of a Free Trade Area of the Asia Pacific (FTAAP), are totally misguided. In fact, as shown by the experiences in negotiating the various ASEAN+1 FTAs (such as the ASEAN-China FTA or the ASEAN-India FTA), the binding nature of the agreement tends to increase the number of sectors considered to be "sensitive."

East Asia definitely has become a more open economic region because of significant progress in the removal of border barriers. The first generation economic reforms have achieved this. Regional cooperation (ASEAN and APEC) has assisted in the process, but as it is currently structured it can only go so far as reducing and removing most border barriers. This can be seen as the characteristic of what can be called "first generation" regional cooperation.

So long as the issue of "sensitive sectors" is not effectively dealt with, barriers to protect those sectors tend to be pushed deeper into the economy. They become more complicated and are less transparent.

INTO AN ERA OF "SECOND GENERATION" ECONOMIC REFORMS AND REGIONAL COOPERATION

The notion of "second generation" economic reforms and "second generation" regional cooperation follows directly from the above examination. Economic well-being and competitiveness are not influenced only by openness to trade and competition but also by the region's regulatory and structural architecture.

Second generation economic reforms refer to efforts to tackle the many behind-the-border barriers. It is beyond the scope of this paper to elaborate on this. Tackling behind-the-border barriers requires improvements made to institutional frameworks, regulations and government policies. A major objective of these reforms is to make the functioning of markets more efficient.

In the context of regional cooperation, these reforms could include, but certainly must go much farther beyond, so-called trade facilitation measures. Trade facilitation also aims at making markets more efficient by reducing costs to business operating in and especially between markets. Trade facilitation measures to reduce "transaction costs" include simplification of administrative and procedural requirements (such as, customs procedures and port logistics), standards and conformance, improving transparency, and developing e-business.

ASEAN, APEC and ASEAN Plus Three (APT) have introduced various trade facilitation measures in their agenda. In 2001 APEC set targets on trade facilitation when APEC Leaders agreed to reduce average business transactions costs by 5% by 2006. To this end APEC developed Trade Facilitation Principles and a Trade Facilitation Action Plan (TFAP). At the Ha Noi meeting in November 2006 APEC agreed on a framework to continue the trade facilitation work beyond 2006 to reduce business transaction costs by another 5% by 2010. These are laudable efforts, but they do not go to the heart of the second generation economic reforms.

Beyond-the-border barriers are not always erected to protect a sensitive sector. They may result from institutional or regulatory deficiencies, sometimes due to erroneous or misguided policies. Restrictions and rigidities are often introduced because of lack of capacity to design and administer policies.

In any case, tackling these structural problems is generally found to be difficult

because of complex political economy factors, but the pay-offs can be significant for the domestic economy as well as for the regional economy. This could be the reason why issues of structural reform have been brought into the APEC agenda.

In 2003, as stated in the Chair's Summary, APEC Leaders shared experiences on their efforts in domestic structural reform, "which can be painful but is necessary and beneficial in the long-term." In 2004, they reaffirmed their political commitment to promote structural reform. They adopted the Leaders' Agenda to Implement Structural Reforms (LAISR) that was drafted and submitted by Japan (see Attachment).

In 2005, the Leaders instructed Ministers to work on behind-the-border issues and welcomed the adoption of the APEC Work Plan on the LAISR towards 2010 (LAISR 2010) "as a policy-oriented approach to bring about needed structural reforms." In the 2006 Ha Noi Declaration the Leaders "recognized the need to intensify work on structural reforms." Australia as chair of APEC 2007 indicated that the work on economic reform "will focus on promoting high-quality economic policy dialogue, strengthening economic infrastructure, and improving regulatory efficiency."

In comparison to APEC, the two other regional cooperation arrangements in East Asia (ASEAN and APT) have not yet introduced economic (structural) reform issues into their agenda. The priority areas of APEC's LAISR are: (a) regulatory reform; (b) competition policy; (c) public sector management; (d) strengthening

economic and legal infrastructure; and (e) corporate governance. The modality of its work is to discover good practice principles within each priority area that may be applicable to the more specific reforms that individual member economies may choose to voluntarily adopt.

The APEC Work Plan on LAISR 2010 proposed that from 2006 to 2010, 2 to 3 coordinating economies, ideally from developed and developing economies, will take the lead on a particular policy issue. The coordinating economies will undertake policy-oriented work in this area, which may include policy dialogue ..., capacity-building projects and a recommendation or good practice paper. This work will be conducted within a one to two-year time frame. The key findings of this work will be submitted to Ministers and Leaders.

The APEC Economic Committee (EC) has been given the mandate to promote structural reform within APEC by undertaking policy analysis and action-oriented work. It is also responsible for overseeing LAISR, and undertakes coordination with other relevant APEC fora, e.g. the Strengthening Economic and Legal Infrastructure (SELI) group, the Competition Policy and Deregulation Group (CPDG) and the Finance Ministers' Process.

There is thus already an opening in APEC to undertake systematic efforts in the area of microeconomic policy reform. However, from the brief examination above it can be said that the new APEC agenda (LAISR) has introduced the concept of "second generation" economic

reform but is short of developing second generation regional cooperation arrangements that can lend strong support to the successful implementation of microeconomic reforms in member economies.

TOWARDS AN EFFECTIVE STRATEGY FOR REGIONAL COOPERATION

Regional cooperation can help improve national capacity for policy development and policy implementation by instituting mechanisms for: (a) sharing policy experience; (b) drawing upon international expertise in relevant policy areas; (c) developing a regional vehicle that can be used for independent review and evaluation of policy performance.

The following are elements of an effective strategy for APEC cooperation to promote microeconomic reform:

- (1) Strengthen the work of the APEC Economic Committee (EC) and relating it to the broader APEC agenda at Ministerial level. The EC should have the capacity to undertake review of policies in some key areas by establishing an Office that serves the EC. This can take the form of an on-going APEC Productivity and Efficiency Commission (APPEC);
- (2) APPEC should have the capacity to respond to requests by APEC and member economies for analysis of micro-policy and regulatory issues;
- (3) This Commission could draw in capacities and research networks

from around the region (EABER and NBER), and be associated with the APEC Secretariat;

- (4) A strengthened EC should be coupled with provision for Ministerial-level direction and responsibility for follow-through;
- (5) Leaders might commission research and analysis of costs and benefits of policy regimes, and Ministerial Sub-Committees charged with follow-up and formulating responses to the implications of the work.

CONCLUDING NOTES

The importance of microeconomic reform for East Asian economies cannot be overstated. APEC provides a useful forum for the East Asian economies to support their efforts to effectively respond to the challenges of second generation economic reform. For APEC's own sake it should make microeconomic reform a priority. This is so because to remain relevant it will have to progress on all fronts, including in its trade agenda,

which includes a leadership role in strengthening the multilateral trade regime.

APEC's microeconomic reform agenda must have a strong Ecotech element, namely capacity building. In fact, APEC's Ecotech program can become much more relevant and coherent than it now is if structured within the structural reform work program. In fact, a meaningful Ecotech program should consist of information sharing, policy development and capacity building.

To conclude, as described above, APEC's strategy to support microeconomic reform in its member economies should have the following essential elements:

- (a) An arrangement to produce independent analysis with transparency in reporting and discussion of results.
- (b) Delivery mechanisms to assist in the enhancement of capacity of member economies for policy development and implementation.
- (c) Follow-through mechanisms to ensure implementation of commitments by member economies.

ATTACHMENT

Leaders' Agenda to Implement Structural Reform (LAISR)

Santiago, Chile, November 2004

The APEC Leaders reaffirm their sustained political commitment made in Bangkok 2003 to promote structural reform and their determination to demonstrate leadership to strengthen implementation of structural reform in the APEC region. They recognize the value of well-executed structural reform, underpinned by institutional capacity building, for achieving sustainable economic growth and supporting APEC's goal of trade and investment liberalization.

The APEC Leaders fully recognize that structural reform improves the functioning of market in order to sustainably enhance living standards and realize the economic potential of the APEC region by raising our economic efficiency and increasing our competitiveness. They stress the importance of structural reform, which provides a crosscutting perspective and potential for greater synergy across APEC's traditional approach to APEC's wide-ranging economic development agenda.

With a view to advancing structural reform initiatives in APEC, the APEC Leaders commit to addressing the following agenda by priority.

- Focus APEC's structural reform-related work on the following as possible priority areas based on its ability to add value to build on its existing work: regulatory reform, strengthening economic legal infrastructure, competition policy, corporate governance and public sector management.
- Identify an institutional mechanism to address structural reform as a major APEC priority, in consultation with the relevant APEC fora and the Finance Ministers' Process, in order to promote APEC's structural reform-related activities in an more enhanced and effective manner.
- Stimulate policy-oriented discussions on structural reform with a view to providing further clear guidance on APEC work.
- Foster understanding of the benefits of structural reform among APEC economies through better reporting process and sharing of good practices.
- Promote further capacity building, including for regulators.
- Strengthening cooperation and collaboration, where appropriate, with relevant international fora, notably the OECD, to deepen and expand structural reform-related activities and measures.

For continued structural reform in each APEC economy, the APEC Leaders acknowledge the relevance to:

- Accelerate domestic efforts and enhance communication with business on priority areas to be identified by each member economy.
- Develop pioneering policies/measures with a view to encouraging the initiation of reforms and promoting domestic regulatory reform.
- Enhance transparency to realize the predictable business environment through reversing those actions that perpetuate corruption.

Major Powers Relations and East Asian Regionalism*

Jusuf Wanandi

THERE ARE two views of East Asia: The pessimistic and the optimistic. The former is based on the Realist school in international relations and is supported mainly by Western scholars and think tanks. The latter view is based on close observations on developments in East Asia, where efforts are being made to establish new regional institutions. Obviously, these observers—who are mostly from East Asia—have not only followed these developments closely but have also been involved in the efforts, particularly through second track activities. Yet, they are not overly optimistic in their assessment and some are rather vicious in evaluating developments in the region and in their own countries. However, they are optimistic because they see the great opportunity of, and are given the chance to participate in, an emerging East Asia that might become the center of development and progress in the mid 21st Century.

The pessimists believe that East Asia has to depend primarily on the balance of power because regional institutions and

regional order, like NATO or the EU in trans-Atlantic and European relations and development, are almost non existent in East Asia. In addition, there are also real flashpoints in East Asia that have not been stabilized, such as the DPRK proliferation of nuclear weapon, cross-straits relations between China and Taiwan, and the overlapping claims in the South China Sea.

They also recognize that deeper problems might arise from the relationship and competition between the two big powers, namely China and Japan, who for the first time in history are both powerful at the same time. They not only face the problem of competition for leadership, but also problems of disputed maritime border in the East China Sea, and the emotional problem of interpretation of their recent history.

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Another problem is the future relations between the US as the only superpower and China as the aspiring one. As happened in Europe at the beginning of the 20th Century, despite the good and strong economic relations, World War I broke out because the politics were not appropriate in dealing with Germany as the new and upcoming power. This could happen in East Asia, despite deepening economic integration, because of the lack of common norms and credible institutions to cope with a rising great power like China. The pessimists also point to the fact that East Asia regional institutions remain under-developed and are based on "shallow" cooperation.

Based on the factors mentioned above, it could be expected that instabilities, tensions and conflicts may arise. Regional instruments and common principles cum norms are necessary to prevent that from happening.

The second view is cautiously optimistic about the future of East Asia. It is partly based on some realism but this is tempered by the ideas of regionalism and regional cooperation. Their vision of East Asia's future is an East Asian Concert of Powers, involving the US, who still has primacy in the region, and an upgraded East Asian Summit (consisting of the ASEAN 10 and the 6 partners: China, Japan, South Korea, India, Australia and New Zealand).

For some time to come the primacy of the US will be the mainstay of East Asia's stability while an East Asian Community is being established. Therefore, the US has

to be incorporated into the East Asian community idea although she has lost some of her soft power and has relatively declined her presence in the region, while the economies of China and India are rising and in China's case also politically and militarily.

The flashpoints in the region are under control, and solutions are being worked out. The six party talks (plus the bilateral talks between the DPRK and the US) are the instrument for resolving the problem of proliferation of nuclear weapons of the DPRK. At last every member of the six party talks is now concentrating on the real issue of overcoming the nuclear weapon of DPRK and thus there is a fighting chance that a solution could be arrived at. Moreover, this is so because the US is willing to provide a quid pro quo that is necessary for the DPRK regime to be willing to give up on her nuclear weapons. This will take some more time and some real efforts, but the objective and the ways are now clear for all parties concerned.

On China-Taiwan relations, time is on the side of the Chinese. The two economies are integrating rapidly. To China, the problem is how to win back the hearts and minds of the Taiwanese. China is doing its best and tries to be patient. If the opposition in Taiwan (KMT) could win the 2008 presidential election, the two sides could agree on the status quo and restart the talks towards peaceful reunification. The US can play an important role to keep the policies of both sides stable. Japan, like the rest of the region, has an interest in a peaceful resolution to

the conflict. But Japan should not get involved in US policies on the cross-straits relationship, because that will not go well with the Chinese and will only complicate things.

On the South China Sea, there is an agreement between China and ASEAN on the principles for a peaceful resolution and establishing a Code of Conduct. Stability has been established temporarily, but the Code of Conduct should be concluded soon to strengthen relations between China and ASEAN.

Despite the many problems in the relationship between China and Japan, it is not automatically acute for peace and stability because there are countervailing factors that will help maintain some stability. Economic relations are strong, with bilateral trade now amounting to over 250 billion US dollars, and China has become Japan's biggest trading partner. Investment into China is high. The strong and growing economic relations have helped Japan overcome its recession.

People to people relations continue to intensify, with about 4 million Japanese visiting China annually, 70,000 Chinese students studying in Japan, 250-300 cities/prefecture sister relationships, and 700-800 flights a week between China and Japan. During PM Abe's first visit to China the two sides agreed on an exchange program for the youth, emulating the French-German program (with over 7 million youth exchanges in 25 years), and a joint commission of historians from both countries to reexamine their interpretations. Both sides also strongly support the

establishment of an East Asian Community, and they recognize that its establishment hinges on the normalization of their bilateral relations. Normalization of the bilateral relations will not be easy because of a certain sense of competition for leadership in the region. But this is not impossible if there is political will on both sides. In fact, efforts to create an East Asian regional institution could provide a politico-strategic environment that will encourage greater cooperation between the two.

The China-US relationship is the most important bilateral relations affecting developments in East Asia. It is a complex relationship between the only superpower and an aspiring future superpower. History shows that relations between two such countries have never been easy, but they need not automatically be confrontational, e.g., the relations between the UK and the US in the 19th and the 20th century.

The failure to structure politico-strategic relations between the major powers in Europe at the end of the 19th century and beginning of the 20th century is a good lesson to learn. The continuation of conflict into World War II and the Cold War was mainly due to ideological fanaticism of Fascism-Nazism and Communism.

The political and strategic environment today could be more serious than one hundred years ago. Relations between China and the US could develop into another "Cold War", but this could also be prevented. An important aspect in the relationship is China acceptance of the

international order and regional order that have been laid down by the US after World War II. Therefore, she is not another USSR that was competing against the US on the basis of a totally different and opposite ideology, politics, economics and social order.

That is why Robert Zoellick, former Deputy Secretary of State, has proposed the idea of China as a responsible stakeholder. This idea provides a relevant basis for the relationship. But there are two caveats. First, being a stakeholder China should also take responsibility in and not become a free rider in the development of the global and regional order. This means that China has to abide by the global rules and take an active part in humanitarian affairs because she has become a global (and regional) leader. Second, the US also has to accept some exceptions for China because as a late comer she needs time to adjust to an order that she is ready to embrace but was not involved in its creation. The US should engage in many dialogues with China to allow this to happen.

In some instances, China has adopted mercantilist policies because she does not know better and has to learn to implement new rules. China should support the US on the issue of Iran's proliferation as she has done on the DPRK's. Furthermore, she also has to adopt policies that disprove the excesses of Sudan in Darfur, Mugabe in Zimbabwe and Than Shwe in Myanmar.

Hank Paulson, US Secretary of Finance, has implemented this basic attitude towards China by establishing regular

dialogue at the ministers' level to discuss important bilateral, regional and international issues. Similar dialogues on strategic and security issues also need to be held.

China realizes that the US remains the only superpower, and that good relations with the US will be instrumental for her modernization efforts. President Bush is perhaps the best US leader they can have on the Taiwan issue because he tries very hard to put the pressures on both not to cross the red line on the straits relations while adopting the traditional ambiguous policy towards both.

In fact, with the erosion of President Bush authority due to the war in Iraq and the dominance of the Democrats in both Houses of Congress, China might face more pressures from Congress, and the President as Chief Executive on security and foreign policy could not come to China's defense as much as before.

In view of the fact that relations between the US, Japan and China have become so intertwined, not only in the economic field but also in the political and security fields, a G-8 type of institution for strategic dialogue and cooperation is of critical importance for East Asia.

Beyond that East Asia should have an institution that can help the region cope with the emergence of China, to deal with the possible rivalry between China and Japan, as well as the potential adversarial relations of the US as the only superpower and China as the potential new one. This provides the strategic underpinning for the establishment of an East Asian Community.

East Asia's economic integration has been driven by market forces. But it has now reached a level where governments need to take a more active role to sustain and deepen the integration. Governments must take the necessary measures to remove legal and bureaucratic obstacles as well as establish norms and institutions to further organize the region.¹

The emerging institution in East Asia is not likely to become the one like in Europe, which is based on norms and institution and is organized in a top-down manner. Instead, regionalism in East Asia is basically market-driven. Intra-regional trade among East Asian countries has now reached 55% of their total trade. Regionalism involving such diverse countries in East Asia has first to be based on trust and confidence building and promoting

the habit of cooperation. An East Asian Community will be a long term goal, and will be reached step by step. Cooperation will first be in the economic and functional fields, and later in the political field, followed by cooperation in the security field. Norms and institutions will come later if necessary. Forming an East Asian Free Trade Area (EAFTA) is one possibility.

As has been argued above, according to the cautious optimist, adopting a complete balance-of-power strategy will not be sufficient for East Asia. The primacy of the US role in keeping peace, stability, and progress in East Asia has been eroded because of the relative growth of China and India, and the entire East Asia. Also, much of US attention has been diverted to the Middle East. In

¹ It should be recognized that ASEAN has a role to play as the catalyst for East Asian regional cooperation, because the two big powers could not do the job, at least for the time being. Questions have been asked whether ASEAN can really be at the driver's seat, since her economy consist only 10% of the economy of East Asia. This is a temporary effort. In fact, ASEAN's leadership is mainly in organizing and chairing the meetings, and allows the others to actively set the agenda for cooperation. Some of the ideas to implement the vision came from the other partners of ASEAN. For instance the creation of the East Asian Vision Group was initiated by South Korea's President Kim Dae Jung and the Group was chaired by former Foreign Minister Han Sung-Joo. The process was supported by ASEAN. It was followed by the establishment of a group of officials under the auspices of the Korean government to deliberate on the areas that should be given priority. So, was the free trade idea

proposed first bilaterally between ASEAN and China by ex PM Zhu Rongji of China, and then later followed by Japan and the Republic of Korea (ROK). To have more credibility ASEAN should cooperate with the ROK to assist her in the process of East Asian regional institution building. Russia wants to be included in the East Asia Summit. Her economic relations with the region are still limited. And it will take them up to one decade to participate fully in the economy of East Asia, and thus could fully participate in the EAS. Her main attention is now geared mostly towards Europe, including in the energy sector. India is already a member of the East Asia Summit because of her footprint in the region, historically, presently and more so in the future. So too are Australia and New Zealand, that are involved very intensely in the region. The EU is already engaged with East Asia through ASEM, and how she will fit in the EAS as a forum for strategic dialogue should be studied.

addition, the region needs an institution to be able to deliberate on strategic issues and problems of the region, a kind of G-8 for East Asia.

That is why the US primacy should be combined with a regional multilateral East Asian institution that together will become a new Concert of Powers for East Asia. It will take the form of an enlarged East Asia Summit that involves the US. Now that the US has begun to appreciate the importance of an East Asian regional institution and do see her national interest in joining it, it will not be too difficult for her to do so. It is not impossible for the US to sign ASEAN's Treaty of Amity and Cooperation (TAC) to be able to join the East Asia Summit, because the TAC is mainly a political document. This enlarged Summit could be held once every two years alternately with the APEC Summit, or it could be held back to back with the APEC Summit. This will make it possible for the US President to attend.

Since the East Asia Summit will largely be a forum for strategic dialogue, the agreed policies and actions could be implemented by the ASEAN Plus Three (APT) especially in economic and functional cooperation. This suggests that the APT must be flexible and be open for the participation of other relevant members of the East Asia Summit. For instance, Australia should take part in the Chiang Mai Initiative. Security issues, including CBMs and human security issues, can be handled by the ASEAN Regional Forum (ARF). If the six party talks are successful, it could be the basis for regional cooperation on hard security issues.

As stated before, the East Asian Community will be comprehensive in scope, covering economic, political and strategic aspects. First, it is meant to help the region cope with the impact of the peaceful rise of China, which is so dramatic and will change the progress and importance of East Asia to the world. In a regional context it will allow the smaller countries to feel more comfortable in dealing with such a huge China, if done together. Furthermore, it will keep China honest, following the agreed rules and norms. This is to guarantee that China's rise will not disrupt regional peace, stability and progress.

The rise of China has been unprecedented in human history with its economy growing at 8 to 10% annually for the last 25 years as has happened in some Western European countries in the 19th century after the Industrial Revolution as well as in Japan, Taiwan and South Korea between the 1960s and 1990s. It has been unprecedented because it happened in a country with 1.3 billion people. She has the potentials to continue at the same pace for the next 20 to 30 years, if she can overcome new challenges or even possible calamities that she might face in the future.

Predictably China's economy could become as big as the US' approximately in 2020 and could even begin to surpass it. Some corrections, economic and political, might have to be made, resulting in slower growth for some years or even a decade. However, she could resume her economic growth after such an interval. But such a correction could also become

a big crisis, and the region (as well as the world) should cooperate on how China can cope with such a crisis, because every country, especially in the East Asian region, is deeply integrated with China's economy.

Unless it collapses, which is a remote possibility, China is bound to become a big economic entity, although in per capita terms, she could catch up with the US only in the middle of this century. The Chinese people and their leaders have been upbeat about their achievements, and they have made use of those results cleverly. But at the same time they have to admit that the problems caused by high growth and deep changes are also huge and complicated and should be given their main attention and focus. Those are the problems of unemployment, income disparity between the coastal part and the inland part, corruption and governance issues, fragility of the state banks, under-performance of state enterprises, the plight of the farmers, and last but not least the problems and challenges of political development.

The main internal constraint on China's growth is institutional: the lack of rule of law, the consequent uncertainty of property rights, the inefficiency of state enterprises, and the profound weakness of the financial system. Important symptoms of these weaknesses are the reliance on foreign entrepreneurship and offshore financial and legal centre, primarily in Hong Kong.

Behind these weaknesses is something more profound, namely a political system

that is not completely compatible with an increasingly sophisticated economy and society. The political transition from a single party state to a more democratic regime is always problematic and difficult. China also has to confront external challenges. China's extraordinary success in export markets has been a powerful engine of growth. However, will this be sustainable since she has already become a huge player in world trade and her economy is already quite open?

The challenges ahead for China are huge by any standard. But it is a good bet that China will continue to grow rapidly for at least another two to three decades. This will require continuing and painful reforms, but failing to do so and risking to lose her economic dynamism must be seen as a worse option by China's policy makers.

On top of the seriousness of their challenges is the burden of numbers. However small the problem is, if multiplied by 1.3 billion, it will become an enormous problem to be faced by the leadership. On the other hand, however big the result is, if divided by 1.3 billion, it could be small and negligible. This is the paradigm of China's challenges ahead as proposed by Zheng Bijian, advisor to President Hu Jintao.

In foreign affairs they also face real challenges. First, there are 13 countries bordering China and they have to take care of such diverse regions as Russia, Central Asia, South Asia, Southeast Asia and Northeast Asia, each with its own challenges. But Northeast Asia should be

their most important region, because of Japan and the US presence in that region.

Russia is important because of the long border and energy source in the future, but also as a partner in multipolar world. Central Asia has become important due to problems of terrorism in Xinjiang and because of China's enormous energy needs.

South Asia is becoming more important due to India's rise as another economic giant in the medium term, and the balance she has to keep with India for future stability and peace, especially in the sub-continent as well as in East Asia, where India is increasing her presence. Pakistan's special relation with China is to be kept in balance with her relations with India.

Southeast Asia has become a sub-region of importance to China, in economic and strategic terms. Economically, Southeast Asia is an integral part of her manufacturing platform for the world, and is an increasing market for her products as well as source of natural resources for her economic development. Strategically, ASEAN has become an important partner for peace and stability in East Asia. Especially in the efforts to build an East Asian Community, ASEAN could play its role as both the catalyst and the driver.

Second, East Asian regionalism will create an environment that will be conducive for China and Japan to cooperate for the sake of the East Asian region as well as for their own national interest. Sometimes it will be easier to cooperate together with and in the regional insti-

tution than only having bilateral relations. It will be easier also to put things in a regional context to make some policies palatable to domestic constituencies.

Third, if China is a responsible and respectable regional partner in the East Asian Community, it will be easier to convince the US that China is not a revolutionary power that is against international and regional norms as established since after World War II by the US.

Having the US presence in the East Asia Summit is important, because with her primacy in the region, although her soft power is declining, she is still a stabilizing factor. She is much more needed inside than outside the regional institution.

East Asia regionalism, ASEAN Plus Three, East Asia Summit and East Asia Community are institutions to guarantee the peaceful rise of China by absorbing her as a responsible member of the region. It will also lay down a regional order and become a regional institution that promotes cooperative relationship between China and Japan, and China and the US.

A concert of powers in East Asia, in the form of a G-8, should be created for strategic dialogues and strategic cooperation. This kind of regional instrument is needed because the integration of region has become deeper. Because of her primacy in the region the US has to be included to make it credible and effective.

East Asia Community is not only for economic cooperation, but also for political and strategic cooperation. And if it needs

institutions and norms in the process, then it should be established.

At this juncture, differences of values still exist. These include such values as liberal democracy and political development as well as norms for regional institutions. That is why a step by step approach and a long term plan should be established and agreed upon, starting in the economic field, which is already integrating fast. But convergence on norms and values are also happening everyday: civil liberties, rule of law, good governance, democracy (or political space and freedoms), and capitalism.

The younger generation in East Asia is the critical mass for the future and already begins to define the new values and norms that are converging. In tandem with this is the need for a new model of development for East Asia, where problems of resource and energy security, water and the environment could be handled jointly by the region.

Since East Asia is going to become the next important region, the responsibilities of the East Asian regional institutions in delivering and supporting global common goods should also be considered as an important part of the rise of the region.

Proliferation Security Initiative (PSI): Indonesian Perspective

Hasjim Djalal

IN 2003, the United States announced a new Initiative in security affairs to prevent the proliferation of weapons of mass destruction (WMD), their delivery systems, and related materials worldwide. The WMD could be biological, chemical, or nuclear, and their delivery systems could be through land, the sea, or airspace. It was not clear whether the radiological weapons were included in the WMD meaning.

The US initiative, supported by its partners in the 'coalition of the willing', was motivated by the global fight against terrorism and the fear that the WMD could fall into the hands of terrorists or the so-called 'rogue states' which are suspected of supporting terrorism, or the so-called states of 'proliferation concern', such as North Korea and other states which are suspected or known of developing nuclear weapons. Presumably, it was also intended to include Libya (at that time) and possibly also Iran. I suppose "terrorists" relate to Al-Qaeda and its affiliated organizations, and presumably do not include national liberation organizations as long as they are not related to

Al-Qaeda. It appears that the definition of "terrorist" and "states of proliferation concern", in the final analysis, would be subjective and depends on the eyes of the beholders.

So far, it is understood that the US has gathered supports from some 70 or so of its allies and friends who have agreed to the PSI Statement of Interdiction Principles. It is said that more than 40 countries have participated in some 14 training exercise involving military, law enforcement, policy, intelligent and legal experts. In Southeast Asia, Singapore is already a participant in the initiative, while Indonesia, Malaysia, and Vietnam seem not to be so enthusiastic about it. In East Asia, while Japan supports the initiative, South Korea and China did not, at least so far. In the Indian Ocean area, India also seems to be reluctant to join the Initiative, while Australia is already a participant. The participation in the PSI is voluntary and the actions taken in support of the PSI are expected to be consistent with national authorities as well as with International Law.

Yet, in the mind of some people, the Initiative, if implemented, may fundamentally affect the development of the Law of the Sea and maritime issues. It is understood that the Initiative will commit its participants to 'undertake effective measures, either alone or in concert with other states' to interdict the transfer or transport of WMD, their delivery systems, and related materials 'to and from states and non-state actors of proliferation concern'. Those measures would include commitment 'not to transport or assist in the transport' of 'any of those materials and not to allow any persons subject to their jurisdiction to do so'.

What is more dramatic is that the participants 'at their own initiative' or at the request by 'another state', could 'board and search any vessel flying their flag in their internal waters or territorial seas, or areas beyond the territorial seas of any other states' which are suspected of transporting such materials, and 'to seize such cargoes'. It is my understanding that the PSI Principles could also be applicable to the archipelagic waters if the archipelagic state concerned subscribes to the PSI Principle, because the archipelagic waters generally lie between the internal waters and territorial seas. Also, the Principle would also be applicable in the Exclusive Economic Zone (EEZ) of a coastal state if such coastal state is a subscriber to the PSI Principles.

The Applicability of the Initiative

I assume also that the PSI Principles would also be applicable in Straits used

for international navigation, like the Straits of Malacca, if Indonesia and Malaysia join the PSI, because the Straits of Malacca consist of Territorial Sea and EEZ of its littoral states. Equally, 'any vessel flying their flag', could mean the vessel flying the flag of the coastal state and the flag of the requesting state. If this principle is implemented, the participants of the PSI could also 'board, search, and seize' the cargoes of vessels of other countries in the EEZ or on the High Seas beyond their territorial seas.

The request to take effective measures, either alone or in concert with other states for interdicting the transfer or transport of WMD, their delivery systems, and related materials to and from states and non states actors of proliferation concern could create certain problems. "States or non-states actors of proliferation concern" generally refers to those countries or entities that the PSI participants consider that those states or entities should be subjected to interdiction activities because they are supposedly engaged in the proliferation through: (1) their efforts to develop or acquire chemical, biological or nuclear weapons and associated delivery systems; or (2) their transfer (either selling, receiving, or facilitating) of WMD materials, their delivery systems, or related materials

Similar principles are also applicable to aircraft that are suspected of carrying WMD materials that are transiting or over-flying their airspace. Presumably, the PSI Principles could also be applied to foreign aircraft over-flying the airspace of a country. Those over-flying aircraft could

be asked to land for inspection and seizure of the suspected WMD materials, if found.

During the informal discussion of this matter at the Conference on Maritime Security in East Asia in Honolulu in January 2004, while various efforts to counter the spread of WMD were recognized, there were some concerns, however, that the PSI may negatively affect the freedoms of the sea, particularly if the 'board, search and seizure' of the vessels and cargoes are carried out in the EEZ of other countries or on the High Seas beyond the 200 miles EEZ by the participants of the PSI against the vessels belonging to the non-PSI countries. It was suggested that the freedom of navigation on the high seas as well as the flow of regional and international trade could be affected.

Moreover, if there are countries in a geographical region, that are members of the PSI while others are not, the Initiative could create tension between the participants of the PSI and those which are not, because the PSI participants may want to exercise the Initiative against the vessel flying the flag of the non-participants navigating in its EEZ or on the High Seas.

It is understood, however, that the various principles enunciated by the US in the PSI were not or not yet in the form of a treaty or an organization, but more or less in the form of 'code' or 'commitment' to take action by its participants.

Indonesia's Reservations

Some Indonesians, including some officials, apparently, have a lot of reservations with regard to the PSI Principles:

1. The uncertainties with regard to the clear meaning of : (a) what would constitute WMD materials, (b) the clear area of application of the concept (it appears that it could be applicable in all seas and oceans), (c) the possibility of subjective definitions of what constitute "states and non-state actors of proliferation concern", (d) its possible negative impact on regional politics and stability, and (e) lack of scientific and technical knowledge with regard to the WMD materials and how to handle them.
2. Some Indonesian officials are worried that the application of these PSI principles in their territorial sea would not be in conformity with the provisions of the UNCLOS 1982, which among others, guarantee in Article 17 "the right of innocent passage through the territorial sea". Equally, Article 19 of UNCLOS, defines the passage is innocent "so long as it is not prejudicial to the peace, good order or security of the coastal states". Article 19 Paragraph 2 further defines 12 activities that may be regarded as prejudicial "to the peace, good order or security of the coastal states." None of these 12 activities mentioned the ships carrying nuclear material in innocent passage as prejudicial to the

peace, good order or security of the coastal states. In fact, Article 23 of UNCLOS 1982 stipulates that "foreign nuclear powered ships and ships carrying nuclear or other inherently dangerous or noxious substances shall, when exercising the right of innocent passage through the territorial sea, carry documents, and observe special precautionary measures established for such ships by international agreement". Since the PSI Principles are not yet in the form of a treaty or an international agreement, therefore its implementation in the territorial sea maybe regarded as contrary to Article 23. It should also be noted that Article 5 of the Chicago Convention 1944 on International Civil Aviation (ICA) provides that all non-scheduled aircraft of the contracting states shall have the right to "make flights into or in transit non-stop across its territory", and to make stops for non-traffic purposes without the necessity of obtaining prior permission and "subject to the right of the states flown over to require landing". Although in accordance with Article 9 of the Chicago Convention 1944 a country may restrict commercial over-flight in certain areas of its territory "for reasons of military necessity and public safety" or "may require aircraft to land", but this is generally for exceptional circumstances or during a period of emergency. The Chicago Convention 1944 does not provide for interdiction of scheduled commercial aircraft based on suspicion that it carries nuclear or WMD or related materials on board.

3. The PSI also stipulates to: "(a) adopt streamlined procedures for rapid exchange of relevant information concerning suspected proliferation activity, (b) to protect the confidential character of classified information provided by other states as part of this initiative, (c) to dedicate appropriate resources and efforts to interdiction operations and capabilities, (d) and to maximize coordination among participants in interdiction efforts". These would not be easy for Indonesia to implement, particularly "to dedicate appropriate resources and efforts for interdiction operations and capabilities", particularly under its current financial and domestic constraints. Moreover, Indonesia needs legal basis to exchange information with other country or countries. So far, there is no such legal basis to conduct exchange of information or concerted actions on WMD materials with other country or countries
4. There is also the commitment to review and work to strengthen the relevant national legal authorities where necessary to accomplish the objectives of the PSI, and work to strengthen when necessary relevant international law and frameworks in appropriate ways to support these commitments. Indonesian national laws on air and sea navigation are born out of ratification of international treaties. Thus basic principles such as freedom of navigation and overflight are guaranteed. Indonesian national law can

not be designed to justify interdiction which maybe unlawful, unless sanctioned or justified by international agreements or convention to which Indonesia is a party.

5. Furthermore, commitment to take specific actions in support of interdiction efforts regarding cargoes of WMD, their delivery systems, or related materials, to the extent that their national legal authorities permit and consistent with their obligations under International Law and frameworks including:

- a. Not to transport or assist in the transport of any such cargoes to or from states or non-states actors of proliferation concern, and not to allow any persons subject to their jurisdiction to do so. Indonesia has already established mechanism of export control in accordance with international disarmament law. In fact, as indicated earlier, Article 23 of UNCLOS allows foreign nuclear-powered ships and ships carrying nuclear or other inherently dangerous or noxious substances to navigate in innocent passage through the territorial sea, but must carry documents and observe special precautionary measures establish for such ships by international agreements.
- b. At their own initiative, or at the request and good cause shown by another state, to take action to board and search any vessel flying their flag in internal waters or territorial seas, or areas beyond the

territorial seas of any other states, that is reasonably suspected of transporting such cargoes to or from states or non-states actors of proliferation concern, and to seize such cargoes that are identified. Indonesia cannot use its resources to conduct law enforcement as requested by other countries without clear legal basis. Indonesia cannot board vessels, particularly on the high seas, or to force-to-land over-flight without clear legal basis.

- c. To seriously consider providing consent under the appropriate circumstances to the boarding and searching of its own flag vessels by other states, and to the seizure of such WMD-related cargoes in such vessels that may be identified by such states. Indonesian territory, including its ships on the high seas, is under full Indonesian jurisdiction. It would be difficult for Indonesia to surrender its jurisdiction to third countries to board and search its ships in the high seas.
- d. To take appropriate actions to (1) stop and/or search in their internal waters, territorial seas, or contiguous zones (when declared) vessels that are reasonably suspected of carrying such cargoes to or from states or non-state actors of proliferation concern and to seize such cargoes that are identified; and (2) to enforce conditions on vessels entering or leaving their ports, internal waters or territorial seas that are reasonably suspected of carrying such cargoes, such as

requiring that such vessels be subject to boarding, search, and seizure of such cargoes prior to entry. As indicated above, under the provisions of UNCLOS 1982, to which Indonesia is a party, it would seem difficult for Indonesia to implement these clauses, particularly if a vessel is in innocent passages, transit passages, or archipelagic sealanes passage, without clear legal authority.

- e. At their own initiative or upon the request and good cause shown by other state, to (i) require aircraft that are reasonably suspected of carrying such cargoes to or from states or non-state actors of proliferation concern and that are transiting their airspace to land for inspection and seize any such cargoes that are identified; and/or (ii) to deny aircraft reasonably suspected of carrying such cargoes transit right through their airspace in advance of such flight. Indonesia apparently is not sure whether these stipulations could be regarded as in conformity with the Chicago Convention 1944 on Civil Aviation.
- f. If their ports, airfields, or other facilities are used as transshipment points for shipment of such cargoes to or from states or non-state actors of proliferation concern, to inspect vessels, aircraft, or other modes of transport reasonably suspected of carrying such cargoes, and to seize such cargoes that are identified. I understand that this stipulation is further elaborated in the Container

Security Initiative (CSI) and I understand that Indonesia has indicated positive response to these initiative, but so far it has not been implemented.

6. With regard to the possibility of applying interdiction under the principles of PSI in Straits used for international navigation, it seems to me that the littoral coastal states would also have difficulty in applying the principles in view of Article 38 (1) of UNCLOS 1982 which assures that "all ships and aircraft enjoy the right of transit passage, which shall not be impeded". Article 38 (2) defines "transit passage" as the "freedom of navigation and overflight solely for the purpose of continuous and expeditious transit of the Straits" without "entering (the port), leaving, or returning from a state bordering the Strait". Article 39 defines the duties of ships and aircraft during "transit passage" and these duties do not include the prohibition to carry WMD materials. Indeed, the coastal state has the right to adopt laws and regulations relating to transit passage, but they seem to be limited to safety of navigation, prevention, reduction and control of pollution with regard to oil and other noxious substances, the prevention of fishing and the loading and unloading of any commodity, currency, or person in contravention of the customs, fiscal, immigration or sanitary laws and regulations of states bordering the straits. In fact, Article 42 further stipulates, "such laws and regulations shall not discriminate in form or in fact among foreign ships or

in their application have the practical effect of denying, hampering or impairing the right of transit passage as defined in the UNCLOS.

7. In archipelagic waters, in which an archipelagic state has sovereignty, according to Article 52, "ships of all states enjoy the right of innocent passage through archipelagic waters", similar to the right of innocent passage in territorial seas, although the archipelagic states "may, without discrimination in form or in fact among foreign ships, suspend temporarily in specified areas of its archipelagic waters the innocent passage of foreign ships if such suspension is essential for the protection of its security." Moreover, an archipelagic state may also designate archipelagic "sea lanes and air routes there above, suitable for the continuous and expeditious passage of foreign ships and aircraft through or over its archipelagic waters and the adjacent territorial sea". All ships and aircraft enjoy the right of archipelagic sea lanes passage in such sea lanes and air routes. "Archipelagic sea lanes passages" means the exercise in accordance with the Convention of the rights of navigation and overflight in the normal mode solely for the purpose of continuous, expeditious and unobstructed transit between one part of the high seas or an Exclusive Economic Zone and other part of the high seas or an Exclusive Economic Zone. Indonesia, after extensive consultations with maritime powers and IMO, has established 3 North-South Archipelagic

Sea lanes through its archipelagic waters as stipulated in the Government Regulation No. 37 of 2002. Those sea lanes include (1) routes from the South China Sea through Karimata Straits and Sunda Straits to the Indian Ocean, (2) from the Celebes Sea through the Strait of Makassar and the Lombok Strait to the Indian Ocean and (3) from the Pacific Ocean through the Moluccas Sea, the Seram Sea and the Banda Sea, with branches out through the Sawu Sea to the Indian Ocean, through Leti Strait to the Timor Sea and through the eastern Banda Sea to the Arafura Sea, eastern Australia and the South Pacific.

8. In the Exclusive Economic Zone (EEZ), according to Article 58 of UNCLOS 1982 all states enjoy "the freedoms of navigation and overflight". Equally, on the high seas beyond, in accordance with Article 87 of UNCLOS 1982 all states also have the freedoms of navigation and overflight as well as other freedoms enumerated in the Article.

In view of all these Law of the Sea stipulations, which Indonesia and the majority of countries in the world have ratified, it would seem difficult for Indonesia to comply with the PSI principles, particularly if it would be implemented in the waters under its territorial sovereignty. It would be more difficult for Indonesia if such interdiction would be carried out upon Indonesian vessels by foreign powers who subscribe to the PSI Principles, because such an interdiction

would be easily interpreted by many Indonesians as violating their territorial sovereignty or at least an affront to their sovereignty.

Many approaches have been made to Indonesian authorities from the highest up to the bureaucratic and academic levels, persuading Indonesians to subscribe to the PSI Principles and participate in its implementation. Even President Yudhoyono, after some approaches, have instructed the relevant Indonesian Ministers to study the problems. At one point, the Defense Minister have indicated that Indonesia may accept the PSI partially and on ad hoc adherence on a case by case basis, such as with regard to the Straits of Malacca. However, after discussion of the matter with the Parliamentary Commission on Foreign Policy and Defense, it was strongly rejected by the Parliamentary Commission, thus practically ended the attempt by the Government to subscribe to formally the PSI Principles.

Reasons for Not Joining PSI

In my view, there are several reasons for Indonesia not to be so interested to join the PSI and participate in its implementation:

PSI and International Law cannot be reconciled

1. Indonesian officials consider that it would be difficult to reconcile the PSI with the relevant rules of International Law regarding the internal waters, archipelagic waters, territorial seas, straits used for international navigation,

Exclusive Economic Zones and high seas beyond. It is ironic that coastal states, particularly Indonesia and Malaysia, would like to have stronger rights in protecting the waters under their sovereignty and sovereign rights during the Law of the Sea Conference from 1973 up to the conclusion of UNCLOS in 1982. But it was the maritime powers, particularly the US, that worked very hard to limit those powers in favor of the so-called "freedoms of navigation". Yet, now those maritime power that would like to limit the freedoms of navigation in order to limit proliferation of the WMD and the WMD materials. In fact, the United States, more than 24 years after the conclusion of UNLOS 1982 still has not ratified the Convention. In Southeast Asia, as far as I know, only Thailand and Cambodia that have not ratified the Convention.

The issue of compliance

2. Indonesia is a very strategic and large archipelagic country situated between two major oceans and connecting two major continents. In fact it serves as a very important navigation link between Africa, Europe, the Middle East, and Southeast Asia, with the vibrant development of East Asia. Hundreds of vessels of all flags passing through Indonesian waters. It would be a monumental task for Indonesia to comply with the PSI Interdiction principles and a tremendous job to interdict vessels that are suspected to carry WMD materials. It would be equally a big job to comply with

various request for interdictions that may be submitted by some 70 or so countries that are said to have subscribed to the PSI.

The consequences of interdiction

3. There is a possibility that Indonesian commercial vessels maybe interdicted on the high seas by other PSI members. As far as I remember, the PSI Principle recognized the right of its subscribers to interdict on the high seas, and interdiction on the high seas could be carried out after being permitted by the flag state. As I understand it, the United States has concluded several agreements with several flag states that would allow the United State to interdict, board, and inspect vessels flying their flags and seize WMD materials if found on board. I assume that the interdiction, board and inspection may also result in the arrest of the vessels if found carrying WMD materials. Although Indonesian authorities could also interdict foreign flag vessels on the high seas for suspected of carrying WMD materials if Indonesia join the PSI, in practice it would not mean much to Indonesia because it does not have enough capacity to do so either in term of enforcement force or in term of sufficient knowledge and technical capacities to deal with WMD materials. Indonesia is already overwhelmed by the need to protect its national unity and integrity, to stamp out illegal fishing, all kind of smuggling, and all kinds of maritime crimes in its waters, let alone to enforce PSI on the high

seas beyond its current reach. The end result would be that it would be Indonesian commercial and cargo vessels that could be interdicted in all the oceans while the probability for Indonesian authorities to interdict other vessels in the open oceans beyond its waters would be minimal if not non-existence

Domestic protest

4. It has been said that interdiction of a commercial/cargo vessels on the high seas would have to be with the approval of the flag step. In fact this would be in accordance with International Law. Yet, Indonesia could be subjected to another problem, namely political. Under the current situation, if Indonesia approves the interdiction by other forces of vessels flying Indonesian flag, the Indonesian Government could face domestic protest for sacrificing its sovereignty, because under international law a vessel is regarded a "territory" of the flag state. On the other hand, if Indonesia rejects the request it could also be subjected to foreign complaint and accusation that Indonesia maybe protecting the Proliferation of the WMD materials.

No commitment to implement the PSI project

5. Specifically with regard to the Straits of Malacca and Singapore, during the last Conference in Kuala Lumpur in September 2006, organized by the three coastal countries (Indonesia, Malaysia, and Singapore) in cooperation with IMO the promotion of safety of

navigation and environmental protection in the Straits have been discussed extensively. During the Conference the three coastal states have submitted 6 projects to improve safety of navigation and environmental protection, including Project no. 2 on "Cooperation and Capacity building on HNS (Hazardous and Noxious Substances) preparedness and response in the Straits of Malacca and Singapore". The purpose of the project is to enhance the preparedness and response capabilities of the littoral states to deal with any ship that may be involved in hazardous and noxious substances incident. Although WMD material is not specifically mentioned in the Project no. 2, I feel that increasing the knowledge and capacity of the coastal countries to deal with the HNS would also sooner or later increase their knowledge and capacity to identify and deal with the WMD materials. Initially the capacity building project is envisaged for two years, costing about USD3.5 million. So far, no one (user states) has committed to assist to implement the project. It would be useful if the PSI initiators commit themselves to help implement the Project.

Cooperation between Indonesia and the PSI members

6. In my view, Indonesia, being a country which has suffered so much as the result of terrorism, is not opposed to efforts to curb and prevent the spread of WMD materials including the possibility of developing chemical, biological, and nuclear weapons. There-

fore, Indonesia as stated earlier, had indicated positive response to the United States suggestion on Container Security Initiative (CSI) to prevent vessels entering or leaving Indonesian ports with WMD materials. Yet, after some consultation on this matter with the United States, somehow for the reasons unknown to me, the CSI with Indonesia has not materialized. I personally hope, however, that detecting devices to monitor and check containers suspected of carrying WMD materials in Indonesian ports could still be pursued and implemented as discussed between the United States and the Indonesian Government officials. I also hope that although Indonesia does not, so far, officially joined the PSI, it does not mean that Indonesia is supporting the Proliferation of the WMD. Indonesia therefore would hope that cooperation between Indonesia and the PSI members would continue in different format to prevent the spread of the WMD materials and its delivery means.

PSI and Regional Arrangement

In my view, the principles that 'board and search' of foreign vessels by another vessel of different flag on the High Seas or EEZ, is already increasingly being used now in the development of the Law of the Sea and maritime issues. Article 21 of the UN Fish Stocks Agreement (1995) implementing Article 63 and 64 of UNCLOS authorizes 'the board and inspect' of fishing vessels on the High Seas by the law enforcement officers of non flag state

country, if such fishing vessels violate Regional conservation and management measures adopted by Regional Organization concerned. Article 26 of the Honolulu Convention (2000) for the Conservation and Management of Fisheries in the West and Central Pacific Ocean Region, in implementing the 1995 UN Fish Stocks Agreement, also authorizes such interdiction in the defined area of the West and Central Pacific Ocean. Both the 1995 Agreement and the Honolulu Convention of 2000 are already in force.

So, the principle of 'interdiction on the High Seas' could become part of 'International Law'. But, this principle should be adopted through Regional Arrangement or Organization, in the sense that if such interdiction takes place in a Region, it should be subjected to Regional Arrangement applicable in the Region or sub-Region. Otherwise, it may be regarded as a violation of International Law, a violation of the principles of the freedom of the sea, and could even be regarded as an affront from countries outside the Region to the countries inside the Region, particularly if the countries outside the Region are much more powerful than the countries in the Region. The regional initiative in this matter could include, as necessary, countries outside the Region that have interests in the prevention of the proliferation of the WMD; just as the countries outside of the Region in the 1995 UN Fish Stocks Agreement and the 2000 Honolulu Convention could also participate in the regional fisheries conservation and management measures if they have

interests in such measures, either as far distant fishing nations, or as 'administrator' of certain South Pacific islands territories, or otherwise.

Concluding Note

The PSI issues are very important for Indonesia, particularly because Indonesia lies between 2 major oceans and surrounded by several seas that are likely to be used for the transport of those materials. Equally, Indonesia lies between 2 continents. Indonesian seas and airspace are heavily used by sea and air transportation between those continents and oceans. Moreover, as indicated above, Australia and Singapore are already participants in the Initiative.

Indonesia, while actively participating in the global efforts to fight terrorism, including in the efforts to prevent the spread of WMD to its country, its region, as well as globally, should have certain interests in supporting the Initiative. Yet, being a very large archipelagic country, having more than 3 million km² of archipelagic waters and more than 5 million km² of airspace, certainly it would not like to see the participants of the PSI or its neighbors exercise the initiative to board, search and seize vessels suspected of carrying WMD in its archipelagic waters, territorial seas or Economic Zone, or in its airspace, except through arrangement in which Indonesia is a participant, including through Regional Arrangement in which Indonesia participate actively in its formulation and implementation.

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